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IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No. 743

C. RUSSELL FELDMANN, CHARLOTTE M. FELDMANN, JOSEPH V. McKEE, JR., CAROLYN OTTO, PHYLLIS McKEE and BARBARA JANE FELDMANN,

Petitioners,

—against—

JANE PERLMAN, ARTHUR KRAMER, INGER LAWRENCE, MURIEL LAWRENCE, A. CHARLES LAWRENCE, INGER LAWRENCE, MURIEL LAWRENCE, EDITH LAWRENCE and JAMES J. LAWRENCE, as joint tenants with right of survivorship, ISAAC WAGNER and HARRY MERNOFF,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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No.

C. RUSSELL FELDMANN, CHARLOTTE M. FELDMANN, JOSEPH V. McKEE, JR., CAROLYN OTTO, PHYLLIS McKEE and BARBARA JANE FELDMANN,

Petitioners,

—against—

JANE PERLMAN, ARTHUR KRAMER, INGER LAWRENCE, MURIEL LAWRENCE, A. CHARLES LAWRENCE, INGER LAWRENCE, MURIEL LAWRENCE, EDITH LAWRENCE and JAMES LAWRENCE, as joint tenants with right of survivorship, ISAAC WAGNER and HARRY MERNOFF,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit (Clark and Frank, JJ.; Swan, J., dissenting), reversing the judgment for the petitioners herein entered by Hincks, J. (now Circuit, then District Judge).

CITATIONS TO OPINIONS BELOW

The opinion and findings of the District Court (R. 17a-89a) are unreported and are printed in Appendix A*

*References to Appendix A are indicated as "*infra,* p. A- ".

hereto (*infra,* p. A-17). The opinions in the Court of Appeals, printed in Appendix A hereto (*infra,* p. A-3), are reported in 219 F. 2d 173.

JURISDICTION

The judgment of the Court of Appeals was entered on January 26, 1955 (R. 265b, *infra,* p. A-1). Rehearing requested by Newport Steel Corporation was denied February 28, 1955 (R. 282b). The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254(1).

QUESTIONS PRESENTED

1. Whether the Court of Appeals erred in failing to hold, as required by governing state law, that petitioners, as stockholders of an Indiana corporation, neither owed nor breached any fiduciary duty to the corporation or the other stockholders of the corporation in selling their outstanding stock to third persons where the unreversed findings of the District Court show (i) the voting power vested by state law in the outstanding shares sold by petitioners was sufficient to control the corporation, (ii) the purchasers of the stock had a legitimate business motive to acquire control of the corporation, and (iii) as a result of the transaction complained of the corporation suffered no loss or damage?

2. Whether the Court of Appeals erred in failing to hold, as required by governing state law, that when minority stockholders allege that the price received by the sellers of a control block of outstanding stock included a premium for the power of the purchasers thereby to become customers of the corporation, thus allegedly depriving the corporation of some alleged corporate opportunity, such minority stockholders have the burden of proving that a premium was received and that some corporate opportunity was lost?

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3. Whether the Court of Appeals departed from accepted and usual course of judicial proceedings by basing its decision on assumed facts which are contrary to the unreversed findings of fact of the District Court?

4. Whether the Court of Appeals departed from accepted and usual course of judicial proceedings when it reversed a judgment on the merits for petitioners which was based on the District Court's finding that respondents failed to prove the allegations of their complaint, and directed judgment for respondents on the ground that the burden of proof is on petitioners, without remanding the case so as to give petitioners an opportunity to sustain that burden of proof?

STATEMENT

The Court of Appeals has held, contrary to every court decision on the question, that corporate stock and the voting rights appurtenant thereto are not the sole property of the stockholder who owns the stock. It held that when the number of shares owned is sufficient to control the corporation and control is valuable, a controlling stockholder who sells his outstanding stock must share with the other stockholders that part of the sales price which represents the value of control.

This decision, although in a diversity case, is not based on state law but in reality applied what the Court of Appeals believed to be the universal requirements of equity. Thus, if the decision is permitted to stand, it would create a federal rule at variance with the laws of the several states with respect to state-created rights of stockholders in their ownership of corporate stock. As Judge Swan stated in his dissent:

> "... I think that both the legal profession and the business world will find the decision confusing and

will be unable to foretell the extent of its impact upon customary practices in the sale of stock" (*infra*, p. A-12).

This is a minority stockholders' suit brought by seven stockholders of Newport Steel Corporation, an Indiana corporation (F 1, 2, *infra*, p. A-43).* Jurisdiction of the District Court was based upon diversity of citizenship.

Petitioner C. Russell Feldmann represented a control block of 343,375 shares (33% of the outstanding shares) of Newport Steel Corporation (F 9, *infra*, p. A-45).** On August 31, 1950, Feldmann sold these 343,375 shares, plus 55,550 shares owned by friends and associates, to Wilport Company for approximately $8,000,000, or $20 per share (F 70, 71, *infra*, pp. A-65, 66). Feldmann was, and had been for many years, president of Newport and chairman of its Board of Directors (F 10, *infra*, p. A-45).

The remaining 735,117 shares of Newport outstanding at the time were owned by several thousand shareholders (F 8, *infra*, p. A-45); most of these shares and all of the shares sold by Feldmann to Wilport Company, have since been bought by Merritt, Chapman & Scott Corporation, which now owns over 90% of the Newport stock.

Newport was engaged in the steel manufacturing business as well as other unrelated businesses (F 13, *infra*, p. A-46). Except for brief intervals, there had been a shortage of steel in this country for many years, and short-

*F refers to Findings of the District Court printed in Appendix A, *infra*, pp. A-43 through A-87.

**Feldmann owned none of the shares personally. Henney Motor Co., Inc., not a defendant below, owned 50,000 shares and was owned 60% by Feldmann and 10% each by his wife and his three daughters, and Strong, Carlisle & Hammond Co., not a defendant below, owned 261,000 shares and was 85% owned by Feldmann and members of his family. Various members of Feldmann's family, one of whom (McKee) was a director of Newport, owned 32,375 shares; several family members were defendants below, and others were not (F 7, *infra*, p. A-44).

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age conditions prevailed in August 1950 (F 37, *infra*, p. A-54). A group of reputable, substantial end-users of steel offered to buy the control block of shares represented by Feldmann (F 52, *infra*, p. A-59). They indicated that their motive for obtaining control of Newport was so that, as managers of Newport, they could increase its steel production and join the ranks of Newport's customers, buying mainly the additional production which could be achieved, at Newport's regular posted prices* (see F 53, 93, *infra*, pp. A-60, 71; R. 11b, 102a). Feldmann made inquiries concerning the purchasers and found them to be reputable people (F 63, 66, *infra*, pp. A-62, 64).

The stock of Newport was not listed on any securities exchange. In over-the-counter trading, small lots of shares were quoted on August 31, 1950 at 10⅝-11⅝. The book value was $17.03 per share, which in the opinion of Feldmann (who was in the process of building up Newport's steel business) was an undervaluation of $7 to $8 per share. The "sound value" of Newport's steel facilities alone was over $35 per share, as determined by Manufacturers' Appraisal Company in a study made primarily to determine insurable value (F 96, 99, 101, *infra*, pp. A-72, 73, 74). The fair value of the outstanding stock sold, as a control block, was found by the District Court to be $20 per share (F 120, *infra*, p. A-80).

The purchasers made an offer of $18 per share, Feldmann asked $22 per share, and an agreement was reached at $20 per share (F 52, 63, *infra*, pp. A-59, 62). After the transfer of the shares and the payment of the purchase price had been completed, Feldmann and the other directors of Newport resigned and designees of the purchasers were elected in their stead (F 74, *infra*, p. A-66).

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*One of the first acts of the new management was to raise Newport's list prices (Pl. Ex. 34, R. 243b).

(a) Decision by Judge Hincks

Respondents' primary legal position in the District Court was that Newport—because of the Korean war—could have sold steel at premium prices in the so-called "gray market", although there was no proof either that Newport could have sold in the theoretical gray market, or of the prices which Newport might have obtained; that this so-called "right" to sell in the gray market was a corporate asset or opportunity which Newport as a corporation lost because the sale by the controlling stockholders of their own outstanding stock was to end-users of steel; and that the purchasers paid the sellers an exorbitant price for their outstanding stock, in lieu of paying a theoretical gray market premium to Newport itself, for the right to become customers of Newport. Respondents utterly failed to prove that the purchase was not a legitimate investment in Newport's outstanding shares rather than a cloak for a possible gray market transaction,* and the District Court found that the investment value of the stock, based solely upon the prospective earnings of Newport, was so close to the actual sales price as to negative any suspicion of improper intentions on the part of the sellers or the purchasers.

Respondents alternatively suggested, but likewise failed to prove, other possible corporate opportunities which Feldmann might theoretically have obtained for Newport had he remained its chief executive.

Judge Hincks granted judgment for petitioners on the grounds that:

1. The power of the owners of a control block of outstanding stock to control management and corporate

*There was absolutely no evidence that the purchasers, all legitimate and well-known companies, ever suggested, or ever would have agreed to, buying steel from Newport at gray market prices.

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policy is not a corporate asset. Outstanding stock, and its appurtenant voting rights, are the separate property of the stockholders and not the property of the corporation. Therefore, Feldmann breached no fiduciary duty when he transferred control by the sale of outstanding stock of the corporation, and he need not account for the value of control in the manner of a fiduciary selling a corporate asset. His only duty, and one which he clearly discharged, was not knowingly to sell the outstanding stock to persons intending to loot or otherwise cause injury to the corporation.

2. The power of stockholders to select corporate management and the power of management to select customers are not the subject matter of a separate sale; they not only may be transferred with the outstanding shares, but must be transferred with the shares, as their only existence is as an adjunct of such stock.

3. The burden of proof is on the minority stockholders who allege injury or loss of corporate opportunity to Newport resulting from the sale of its stockholders' outstanding stock, to show at least some injury or the existence of some opportunity to the corporation, and respondents failed to sustain their burden of proof.

4. Feldmann exercised all due care in the election of the new directors, and the new directors lived up to their obligations in the management of the corporation; as potential customers of Newport, the purchasers did not jettison old and valued customers or attempt to buy steel from Newport at favored prices.

5. The stock sold had a fair value, as a control block of shares, of $20 per share. It was unnecessary to decide whether defendants had proved that the shares

were worth $20 even if "shorn of [their] appurtenant power to control distribution of the corporate product," as the burden was on the plaintiffs to prove that the shares were worth less, and this they failed to do. That holding required dismissal of the complaint even on respondents' theory that petitioners should account for any premium received, above fair value, because the purchasers intended to join the ranks of Newport's customers.

(b) Reversal by The Court of Appeals

The Court of Appeals (Judge Swan dissenting), holding that controlling stockholders, in selling their stock, act as fiduciaries, and therefore must account to the minority stockholders for profits received, directed judgment for the respondents because of petitioners' failure to *disprove* that the price paid was in excess of the value of the outstanding shares, "shorn of the appurtenant" control over the corporate product, and to *negate the possibility* of the existence of any corporate opportunity.

The crux of the opinion is that controlling stockholders who sell their shares, even where there is no injury to the corporation, have the burden of proof to show that the corporation could not possibly have been better off had such stockholders retained management control.

The Court of Appeals did not limit its decision to a situation where the legitimate business motive of the purchasers of the control block of shares was that they were customers for the corporate product when there was a shortage of supply, but would apparently reach the same result whatever the legitimate business motive for acquiring control.

The Court of Appeals did not set aside any of the findings of fact of the District Court, nor did it make any

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new findings of fact. Ignoring the findings of *good faith, fair dealing, lack of injury, no loss of corporate opportunity,* and *fair value of the stock,* the Court of Appeals predicated its decision upon the unproved assumption that the petitioners were unfaithful fiduciaries who had sacrificed the interests of Newport for personal gain.

In his dissenting opinion (*infra,* p. A-12) Judge Swan pointed out that Feldmann had not acted as a fiduciary in the sale of the stock, that the court had departed from the findings of fact of the District Court, and that in any event the fiduciary principles announced by the majority could not apply to the non-fiduciary petitioners. Moreover, he emphasized the impossibility of the burden of proof with respect to value which the majority of the Court of Appeals placed upon the petitioners, in that a control block of stock cannot be valued as though it did not possess the inherent power to control management and policy.

REASONS FOR GRANTING THE WRIT

I

THE DECISION OF THE COURT OF APPEALS IS IN CONFLICT WITH APPLICABLE STATE LAW.

a. Under Indiana Law, stockholders do not act as fiduciaries in the sale of their own stock.

The Court of Appeals was obliged, under familiar principles, to apply the law of Indiana, where Newport is incorporated, to determine whether Feldmann acted in a fiduciary capacity in the sale of the control block of outstanding shares, before turning to the measure of a fiduciary's duty. This the Court of Appeals did not do.

Judge Clark ignored Indiana law when he held that Feldmann was a fiduciary in the sale of outstanding stock.

Thus, he cites *Pepper* v. *Litton,* 308 U. S. 295, a federal bankruptcy case, to the effect that, in circumstances not pertinent here, a controlling stockholder may be treated as a fiduciary, without reference to the admonition of this Court in *S. E. C.* v. *Chenery Corp.,* 318 U. S. 80:

> "But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?" (pp. 85-86)

In his capacity as an officer and director, Feldmann was a fiduciary of Newport with respect to the management of the corporation and any dealings with it. That is all that is held by the Indiana cases cited in the opinion. From that springboard, Judge Clark assumed Feldmann was also a fiduciary with respect to the sale of the outstanding stock, despite the clear statement of this Court in the *Chenery* case that:

> ". . . the courts do not impose upon officers and directors of a corporation any fiduciary duty to its stockholders which precludes them, merely because they are officers and directors, from buying and selling the corporation's stock." (p. 88)

The Court of Appeals ignored the controlling Indiana authority on the question *whether* there is a fiduciary duty when an officer and director sells outstanding stock of the corporation. In *Board of Commissioners of Tippecanoe County* v. *Reynolds,* 44 Ind. 509 (1873), the Supreme Court of Indiana addressed itself precisely to the question whether, because an officer and director is a fiduciary with respect to the property and business of the corporation, he is also a fiduciary in purchasing or selling outstanding stock of the corporation. Holding that an officer or director

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had no fiduciary duty in that regard, it declared the law of Indiana to be:

> "But stock in a corporation held by an individual is his own private property, which he may sell or dispose of as he sees proper, and over which neither the corporation nor its officers have any control. It is the subject of daily commerce and is bought and sold in market like any other marketable commodity. The directors have no control or dominion over it whatever or duty to discharge in reference to its sale and transfer, unless it be to see that proper books and facilities are furnished for that purpose. As the property of the individual holder, he holds it as free from the dominion and control of the directors, as he does his lands or other property. (p. 515)
>
> * * *
>
> "Such being the nature of the interest of the stockholder in his stock, and the directors having no control, power, or dominion over it or duty to discharge in reference to it, beyond the duty devolving upon them to prudently manage the affairs and property of the corporation itself, it seems to us to be very clear, that, in the purchase of stock by a director from the holder, the relation of trustee and *cestui que trust* does not exist between them." (p. 516)

This decision has never been overruled and is today the law of Indiana. See Ryan, *Should Tippecanoe County Commissioners* v. *Reynolds be Overruled?*, 16 Ind. L. J. 563 (1941).

Thus, under Indiana law, although Feldmann was an officer and director of Newport, he was not acting in a fiduciary capacity in connection with the sale of outstanding shares of stock which were the property of the stockholders and not of Newport. The Court of Appeals' discussion of

the measure of a fiduciary's duty under Indiana law is beside the mark; before that question could become relevant, Feldmann must be found to occupy the status of a fiduciary with respect to the transaction involved—a premise negated by Indiana law.

The ruling in the *Reynolds* case is equally applicable whether the director sells a few shares of stock or a control block of shares because the holding that outstanding stock in a corporation is the stockholder's own private property which he may sell or dispose of as he deems proper is not affected by the number of shares he owns. Every case which has dealt with this question has held that a director incurs no liability by selling a control block of outstanding shares of stock at a profit to persons who have a legitimate business motive to purchase the shares in order to obtain control of the corporate management. The courts have repeatedly held that a control block of outstanding shares may be sold to anyone, at any time, and at whatever price can be obtained, so long as the selling stockholders have no knowledge or reason to believe that the purchasers intend injury to the corporation.

Thus, *Levy* v. *American Beverage Corp.*, 265 App. Div. 208, 38 N. Y. S. 2d 517 (1st Dep't 1942*), held, consistently with the *Reynolds* case, that a stockholder, who was also the president and a director of the corporation, does not act as a fiduciary in the sale of his control block of stock:

> "Of course, a majority stockholder may not knowingly use his position to wrongfully injure one who holds a minority interest, and will incur liability when he does so. The test of common honesty would seem to be a sufficient one to apply in order to

*The Appellate Division, First Department, of the New York Supreme Court reviews very many more stockholders' suits than any other appellate court in the country.

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> determine when a wrong is being done. To apply the rigid rules limiting a fiduciary . . . is to place an unwarranted burden upon the ownership of stock" (265 App. Div. at p. 218).

See also, *Keely* v. *Black,* 91 N. J. Eq. 520, 111 Atl. 22 (1920); *Tryon* v. *Smith,* 191 Ore. 172, 229 P. 2d 251 (1951); *Mayflower Hotel Stockholders P. C.* v. *Mayflower Hotel Corp.,* 173 F. 2d 416 (D. C. Cir. 1949); *Gerdes* v. *Reynolds,* 28 N. Y. S. 2d 622 (S. Ct. 1941 not officially reported); *Stanton* v. *Schenck,* 140 Misc. 621, 251 N. Y. S. 221 (S. Ct. 1931); *Insurance Agency Co.* v. *Blossom,* 231 S. W. 636; 638; (Mo. App., 1921, not officially reported).

The Court of Appeals has not directed judgment for any damage caused to the corporation by the sale to Wilport, and the District Court found there was none. Judgment was directed only for the premium, if any, which was allegedly included in the sales price to represent the value of the power to select the customers of Newport; if there was no such premium, there is no liability.

In other words, the actionable wrong was not the sale of the outstanding control block of stock to end-users of steel. The wrong found was that the petitioners, in violation of Feldmann's alleged fiduciary duty, may have profited on the sale and the resulting transfer of the voting control inherent therein.

Any attempt to equate the legitimate value of the voting power of outstanding shares of stock with a gray market premium for the corporate product is not only wrong in theory but impossible on the record of this case. The record is barren of any evidence that the purchasers would have been willing or able to buy steel from Newport at premium prices above Newport's regular posted prices or from any other mill at gray market prices; the District Court held that no reputable steel producer (including New-

port) sold in the gray market; and the District Court found that the value of the shares, apart from the power to select Newport's customers, was so close to $20 per share as to negate any such equation.

The Court of Appeals thus ignores Indiana law, and every other court decision, that outstanding corporate stock is the sole property of the owners of the shares and that the voting rights of the stock are not held by the owners as trustees for the corporation or the other stockholders.

Unlike cases where a corporate officer or director has personal transactions with his corporation, the transaction here concerns only the sale of outstanding shares of stock, which are the sole personal property of the stockholders and in which the corporation has no direct or indirect rights or interest. It parted with all interest when it sold the shares on original issue. The simple test of this is: Would Newport or its other stockholders have been benefited if the outstanding shares were sold for $5 each instead of $20? Since control passes in either case, the stockholders' position vis-a-vis the Corporation, and the Corporation's position, remain the same at whatever price the outstanding stock is sold. The only persons affected would be the purchasers, who would have gotten more than their money's worth, and the sellers, who would have gotten less.

Or suppose that the stock had been purchased for $20 by persons who were not end-users of steel and there was, as here, no injury to the Corporation: respondents do not claim and the Court of Appeals does not suggest that there would have been any breach of fiduciary duty or any liability to account for profits. Thus, there was no fiduciary duty requiring the stockholders to sell their stock for less than $20 per share, just as there was no fiduciary duty requiring them not to sell their stock to end-users of steel. In fact, since there was no looting by the new stock-

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holders, there is no intimation that there would have been any breach of fiduciary duty if, instead of carefully investigating the motives, identity and reputation of the purchasers in order to safeguard Newport, Feldmann had asked no questions and merely sold the shares at $20.

Thus, it is immaterial that the purchasers of petitioners' stock were end-users of steel which was at the time of the sale in short supply. These facts do not serve to create a fiduciary status where none before existed.

The rationale of the Court of Appeals would apply equally to any sale of a control block of shares where the voting rights of the block of stock acquired were sufficient to elect management, and the purchasers had a business motive for desiring control. This result is not permissible in view of the stockholders' unrestricted rights of sale under state law.

The law of Indiana, as is universally the law, gives to the owners of outstanding shares of stock all those attributes provided by the corporate charter, including the right to vote, and, if a sufficiently large block is owned, the right to select management, who in turn determine corporate policy, determine production, fix the prices for the corporate product and select the corporation's customers. These rights, being an integral part of the stock which was sold by the corporation when the stock was issued, are transferred by each stockholder in turn as he sells the shares, without duty to account for his gains on a profitable sale, any more than there is a right in the stockholders to seek from the corporation reimbursement for their losses on the sale of outstanding stock.

Thus, as the District Court held, it was in keeping with the policy of the law that the selling stockholders resign as directors when they had no further financial interest in the corporation and transfer the rights and responsibilities of management to the new owners. In so concluding, the

District Court specifically held that this was a mere acceleration of what the new owners of the control block of shares would have accomplished at the next stockholders' meeting, and:

> "In my opinion, it would be quixotic and unrealistic to brand as a breach of trust conduct which was free from fraud or overreaching and was neither intended nor effective to cause the slightest harm either to the corporation or other stockholders. [Cases cited]" (*infra*, p. A-28)

The Court of Appeals did not accept respondents' characterization of the election of the new directors as the sale of a corporate asset, *viz.*, the power to control the allocation of the corporate product. The "power to control" lies in the voting rights of the outstanding shares of stock which are the sole property of the stockholder; these voting rights cannot be a corporate asset. But more fundamentally, directors do not have the "power to control" the corporation's assets except in the sense that as fiduciaries they have the right and concommitant obligation to manage the business in the best interests of the corporation and its stockholders. The District Court squarely held, and the Court of Appeals does not disagree, that this responsibility was honestly and capably exercised.

This case involves the sale by petitioners of outstanding stock which they alone owned. The indispensable premise of the Court of Appeals that Feldmann acted as a fiduciary in the sale of this outstanding stock is in conflict with applicable state law.

b. The judgment below rests entirely on a burden of proof ruling contrary to governing state law.

The Court of Appeals compounded its error that Feldmann acted in a fiduciary capacity by its further holding

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that by reason of his fiduciary status the burden of proof shifted to the petitioners. If the Court of Appeals was in error that Feldmann was a fiduciary, the burden of proof point does not arise; the Court of Appeals does not suggest to the contrary. If the Court of Appeals was in error on the burden of proof point, its judgment cannot stand.

In this diversity case the question of which party had the burden of proof must be determined according to the applicable state law. *Palmer* v. *Hoffman,* 318 U. S. 109; *Cities Service Oil Co.* v. *Dunlap,* 308 U. S. 208.

In reaching its erroneous result on the issue of the burden of proof the Court of Appeals relied upon cases dealing with transactions between a corporate fiduciary and his corporation or dealings in the property of his corporation. These cases are entirely irrelevant here. The only transaction involved in this case was a sale by petitioners of their own stock to third parties—a transaction in which the corporation had no interest and from which it suffered neither loss nor damage. The applicable state law on the burden of proof in this situation is clearly contrary to the ruling of the Court of Appeals.

It is not clear whether Connecticut would apply its own rules or borrow the rules of Indiana, but under general law it would probably look to Indiana if burden of proof is so intertwined with the substantive law that to engraft the Connecticut rule would materially alter the Indiana substantive law. *Central Vermont Ry.* v. *White,* 238 U. S. 507; *Overfield* v. *Pennroad Corporation,* 146 F. 2d 889 (3rd Cir. 1943); *Thomas Iron Co.* v. *Ensign-Bickford Co.,* 131 Conn. 665, 42 A. 2d 145 (1945). In this case no different result would be reached by following the law of one state rather than the other because under neither did the burden of proof shift to the petitioners.

The Court of Appeals, however, did not even purport to apply either Indiana or Connecticut law.

The law of Indiana is stated in *Krull* v. *Pierce,* 117 Ind. App. 638, 71 N. E. 2d 617 (1947):

> "The fallacy of such argument, however, lies in the fact that under the rule in this state the burden of proof never shifts from the party who tenders the issue. Though the burden of going forward with evidence to satisfy presumptions may shift during the trial the basic necessity of proving the allegations of the complaint by a fair preponderance of all the evidence always remains with the plaintiff." (71 N. E. 2d at p. 619)

In Connecticut, and in certain corporate fiduciary cases in Indiana, the courts have stated that when the fiduciary has transactions *with* his corporation from which he stands to profit, he may have the burden of proof in justifying the transaction.

But in those cases the plaintiffs had established their prima facie case by showing "the injurious nature of the transaction, appellant's unfairness, and failure to disclose the facts" (*Schemmel* v. *Hill,* 91 Ind. 373, 169 N. E. 678, 685 [1930]); or that a director had sold corporate property and pocketed the proceeds (*Zaring* v. *Kelly,* 75 Ind. App. 15, 128 N. E. 657, 658 [1920]; see also *Sachs* v. *Feinn,* 121 Conn. 77, 183 Atl. 384 [1936]); or that part of the business of the corporation was transferred to another corporation a majority of whose directors were also directors of the selling corporation (*Klopot* v. *Northrup,* 131 Conn. 14, 37 A. 2d 700 [1944]).

The Connecticut law was stated in *Klopot* v. *Northrup:*

> "Where a director of a corporation enters into a transaction *with it* which will inure to his individual profit, we have held that he has the burden of prov-

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> ing that the transaction is entirely fair, made in good faith . . ." (37 A. 2d 700 at p. 703; italics supplied)

Thus, whether we apply the Indiana rule of *Krull* v. *Pierce, supra,* or the Connecticut rule of *Klopot* v. *Northrup, supra,* the respondents have the burden of proof until they have proved some personal transaction between Feldmann and Newport from which Feldmann has profited and which might therefore be viewed by equity as presumptively fraudulent, or void, or voidable.

The two cases cited by the Court of Appeals are consistent with the law of Connecticut and Indiana stated above. In *Pepper* v. *Litton,* 308 U. S. 295, the director and sole stockholder was dealing directly with the assets of the corporation by causing it to confess judgment in his favor. In *Geddes* v. *Anaconda Copper Mining Co.,* 254 U. S. 590, the transaction was the transfer of property between two corporations having common boards of directors. In the *Chenery* case, this Court distinguished a transaction of the *Pepper* v. *Litton* type by stating that *in a sale of issued and outstanding stock* "the courts do not impose upon officers and directors of a corporation any fiduciary duty to its stockholders" (318 U. S., at p. 88).

In a minority stockholders' suit, the burden of proof may shift to a fiduciary defendant because of the presumption of fraud which arises when the minority stockholders have proved self-dealing between the fiduciary and the corporate property.

Only on original issue of stock is there a transaction between the corporation and the stockholder; the resale from time to time of outstanding stock to new owners is not a transaction with the corporation or a dealing in the property of the corporation, nor indeed is it a transaction with which the corporation has anything to do. There is,

therefore, nothing presumptively fraudulent in this case which would shift the burden of proof; respondents merely established (i) the sale of a control block of outstanding stock (ii) during a time of steel shortage (iii) to end-users of steel who bought at Newport's regular posted prices (iv) without injury or loss of corporate opportunity to Newport.

However, even if this proof shifted to the petitioners the burden of coming forward with evidence, that burden was wholly satisfied by the proof tendered by petitioners which persuaded the District Court to find without equivocation that there was no fraud, no injury and no loss of corporate opportunity. The effect of any presumption which shifts the burden of going forward with evidence disappears upon the introduction of evidence which contradicts the presumption (*Adler* v. *Board of Education*, 342 U. S. 485). The District Court on all the evidence granted judgment for petitioners on the merits.

No court has ever suggested that mere proof of a sale by a stockholder, whether of a few shares or of a control block of outstanding stock, casts upon him the burden of negating the possibility that the corporation might have been better off if he had not sold the shares, nor does it permit the inference drawn by the Court of Appeals that the sale "necessarily" resulted in a sacrifice of corporate good will and "unusual profit to the fiduciary who caused the sacrifice", in the absence of any proof to that effect. There is no analogy between the cases which shift the burden of proof to the fiduciary when he profits from transactions with his trust, and a case where a stockholder is selling his own property. In the latter case, there is no presumption of unfairness and the plaintiffs cannot escape their burden of proof.

The Court's departure from the proper application of the rule of burden of proof is even more glaring by its

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direction of judgment against the petitioners who were not officers or directors of Newport, for as to them a fiduciary's burden of proof was obviously improperly applied. These petitioners are Charlotte M. Feldmann, as to whom the only proof is that she sold 2,000 shares of Newport stock; Carolyn F. Otto, who sold 7,300 shares; Barbara Jane Feldmann, who sold 7,800 shares; and Phyllis F. McKee, who sold 7,300 shares (F 7, *infra*, p. A-44).

II.

THE COURT OF APPEALS DEPARTED FROM ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS

a. By assuming facts contrary to the unreversed findings of fact of the District Court.

The gist of the opinion of the Court of Appeals is: *Assuming* that, by the sale of outstanding stock, Newport lost some corporate opportunity or suffered some injury, and *assuming* that the stock was sold at a premium above its value "if shorn of its appurtenant power to control distribution of the corporate product", then the sale was a breach of fiduciary duty; because of the *assumed* breach of fiduciary duty, the burden of proof is cast upon the petitioners to show the fairness of the transaction—in this case, to "negate completely" any corporate opportunity or injury to the corporation and to disprove the existence of any such premium; because in the opinion of the Court of Appeals, Feldmann did not meet this newly imposed burden of proof, judgment was directed in favor of the respondents and those whom they represent, for the amount of the premium, if any, to be determined by the District Court.

This is nothing more than circular reasoning, since the very facts necessary to create the liability were assumed

for the purpose of establishing the basis of liability. The Court of Appeals did not reverse the findings of the District Court that the respondents had proved neither injury, loss of corporate opportunity, nor premium. Therefore, the assumptions of the Court of Appeals are clearly contrary to the unreversed findings of fact of the District Court.

The opinion and the findings of the District Court show that the District Court was convinced that the sale was made in good faith, that Feldmann dealt fairly and with utmost solicitude for the best interests of Newport, and that the loss of corporate opportunity and injury upon which the Court of Appeals predicated its finding of breach of fiduciary duty had no existence in fact. The District Court held:

> "But the plaintiffs contend that the sale was a breach of Feldmann's fiduciary duty because the resulting transfer of control was likely to injure the corporation as Feldmann should have known. For this contention, the facts of the case provide no basis." (*infra,* p. A-24).

It also held:

> "In this connection let me record my concurrence with plaintiffs' assertion that a corporate officer may be held accountable for wrongfully depriving his corporation of a business opportunity without proof that the opportunity, if availed of by the corporation, would have been successful. But before such a doctrine can come into play, there must at least be plain proof of the existence of an opportunity.... There is nothing in the evidence here to satisfy this basic requirement of the doctrine invoked." (*infra,* p. A-26).

And the District Court specifically found that there was no evidence that the "new management has in any way

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failed to do anything which should have been done for the good of the corporation" (F 93 *infra*, p. A-71).

With respect to value, the unreversed finding is that the fair value of the stock sold was $20 per share, which was the actual sales price (F 120, *infra*, p. A-80).

The Court of Appeals assumed that the sales price included a premium for the power to control distribution of the corporate product. To support this position it pointed to the following sentence in the findings of the District Court as limiting the unequivocal finding that the fair value of this control block of stock was $20 per share:

> "What value the block would have had if shorn of its appurtenant power to control distribution of the corporate product, the evidence does not show" (F 120, *infra*, p. A-80).

The opinion of the District Court clearly shows the proper context of this sentence. The District Court held that petitioners had clearly proved that there was no significant disparity between the sales price and the fair value of the stock valued solely on an investment basis, and that therefore, it was not necessary to decide the value of something that did not exist, *i.e.*, whether petitioners had proved that the stock sold had a fair value of precisely $20 per share "if shorn of its appurtenant power to control distribution of the corporate product," because "the burden was on the [respondents] to prove a lesser value for the stock . . . [t]hat burden they have failed to sustain" (*infra*, p. A-37).

The trial judge, holding that respondents had the burden to prove the allegations of their complaint, framed his findings and opinion accordingly and found that there was no evidence to support the complaint. Had the trial judge understood that the petitioners had the burden to *disprove* the allegations of the complaint, the form of his findings and opinion obviously would have been different.

The tenor of his findings and opinion leaves no doubt that Judge Hincks was convinced that the petitioners' affirmative proof had completely disposed of respondents' complaint.

In these circumstances, the Court of Appeals was not free to assume that the allegations of the complaint are true solely because the trial court found that there was no evidence to support the respondents' allegations, rather than finding that petitioners had disproved the allegations. To the contrary, the findings and opinion of the District Court taken as a whole make it eminently clear that Newport was deprived of no corporate opportunity by the sale of the outstanding stock, that the investment value of the shares was approximately the same as the sales price, and that petitioners "received no more than a *pro rata* share of the fair value of the block sold" (*infra*, p. A-23).

The Court of Appeals may not indulge in "presumptions unfavorable to the judgment and for the purpose of reversing it." *Bear Lake Irrigation Co.* v. *Garland*, 164 U. S. 1, 25; *North American Accident Insurance Co.* v. *Anderson*, 100 F. 2d 452 (10th Cir. 1938).

The fact is as Judge Swan pointed out in his dissent, that the District Court found:

> "The 398,927 shares of Newport stock sold to Wilport as of August 31, 1950, had a fair value as a control block of $20 per share. . . ." (F 120, *infra*, p. A-80.)

The above quoted finding required an affirmance of the District Court even on the theory of the Court of Appeals as to fiduciary duty.

The Court of Appeals purported to accept the facts as found by the District Court (*infra*, page A-5); however, it assumed—without proof—that there was some injury to

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or loss of opportunity by Newport and that an improper premium was included in the sales price, assumptions not permissible in view of the unreversed findings of the District Court. The Court of Appeals thus departed from accepted and usual course of judicial proceedings and from the express requirements of Rule 52(a) of the Rules of Civil Procedure.

b. By its directions on remand.

At the trial, the parties and the District Court alike proceeded upon the view that the law required respondents to establish some breach of fiduciary duty, either by proving some injury to Newport or the loss to Newport of some corporate opportunity. The District Court, on express findings that there was no evidence of any injury to Newport or of the existence of any corporate opportunity to Newport which was lost by the sale of the stock, granted judgment on the merits for petitioners.

The Court of Appeals, having held that it was immaterial that respondents had not proved any injury or the loss of any corporate opportunity, on the ground that the burden of proof was on the petitioners to disprove these allegations, directed the entry of judgment against petitioners without allowing them an opportunity to introduce further evidence by which they could satisfy the burden placed upon them of disproving the existence of any injury or the loss of any corporate opportunity (*infra*, p. A-12).

By failing to accord petitioners their day in court on the issues on which it held that petitioners had the burden of proof, the Court of Appeals in effect created an irrebuttable presumption that petitioners were liable no matter what their proof on these issues might show. Even in a case involving a transaction by a director with his corporation—a situation not present here—the law does not interdict the

transaction and create absolute liability; in such a case the burden of proof shifts to the director, but if the director shows by his proof that the transaction was fair he is entitled to judgment.

Not only is it an injustice to deprive petitioners of an opportunity to satisfy a burden of proof applied for the first time by an appellate court, but it is even more unjust in the context of this case, because the opinion and findings of the District Court indicate that it would have found affirmatively that there was no injury and that no corporate opportunity was lost if it thought that findings in that form were required.

The cases are legion that where injustice may be done by proceeding to a final disposition of the case upon the record before an appellate court, it must remand the case for further proceedings and permit the parties to introduce proof consistent with the opinion of the Court. *Willing* v. *Binenstock,* 302 U. S. 272; *United States* v. *Rio Grande Dam and Irrigation Co.,* 184 U. S. 416; *Chicago, Milwaukee Ry.* v. *Tompkins,* 176 U. S. 167; *Illinois Central Railroad* v. *Illinois,* 146 U. S. 387; *Levy* v. *Arredondo,* 12 Pet. 218; *Estho* v. *Lear,* 7 Pet. 130; *United States* v. *Brooklyn Union Gas Company,* 168 F. 2d 391 (2d Cir. 1948); *Porter* v. *Leventhal,* 160 F. 2d 52 (2d Cir. 1946); *Goldstein* v. *Franklin Square National Bank,* 107 F. 2d 393 (2d Cir. 1939); *American Dirigold Corp.* v. *Dirigold Metals Corp.,* 104 F. 2d 863 (6th Cir. 1939); *Magnolia Petroleum Company* v. *Suits,* 43 F. 2d 280 (10th Cir. 1930), cert. den. 282 U. S. 861; *Border Gas Company* v. *Windrow,* 3 F. 2d 974 (5th Cir. 1925).

As this Court said in *Ford Motor Co.* v. *Nat'l Labor Rel. Board,* 305 U. S. 364, 373:

> "It is familiar appellate practice to remand causes for further proceedings without deciding the

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> merits, where justice demands that course in order that some defect in the record may be supplied. Such a remand may be made to permit further evidence to be taken or additional findings to be made upon essential points."

Such also is the law of Connecticut. Where a trial court held that the burden of proof was on the plaintiff and the Supreme Court held that it was on the defendant, the case was remanded for further evidence (*Sisk* v. *Jordon,* 94 Conn. 384, 109 Atl. 181 [1920]).

III.

THIS CASE IS IMPORTANT FAR BEYOND THE INTERESTS OF THE PARTICULAR LITIGANTS.

Shares of stock are a common article of trade and sales of control blocks of outstanding shares in both small and large companies are an every day occurrence, and every day shares are sold in the open market at prices far above or far below book value.

The decision of the Court of Appeals is a drastic departure from the existing law regarding stock ownership, and is contrary to every other court decision on this important question. This novel decision is of all-pervading importance as it affects the rights of every stockholder of every corporation, whether large or small.

Although theoretically the decision below can be said to represent only the view of the Second Circuit, it will be read by lawyers and businessmen throughout the country as an expression of general law. This is particularly true because the decision below purports to apply what it regards as the universal requirements of equity and cites as its authorities cases in this Court and the courts of states other than Indiana.

If the decision of the Court of Appeals is permitted to stand, it will not only create a federal rule at variance with the corporate laws of the several states but it will invite endless stockholders' litigation because of the impossible burden of proof which is imposed upon the sellers. No one selling a control block of shares could ever know to whom he may sell or at what price, because he cannot know what value a court will subsequently find after the shares are hypothetically shorn of one or another attribute of control necessarily transferred with the voting rights inherent in the shares.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

ARTHUR H. DEAN,
HOWARD T. MILMAN,
Attorneys for Petitioners.

SULLIVAN & CROMWELL,
Of Counsel.

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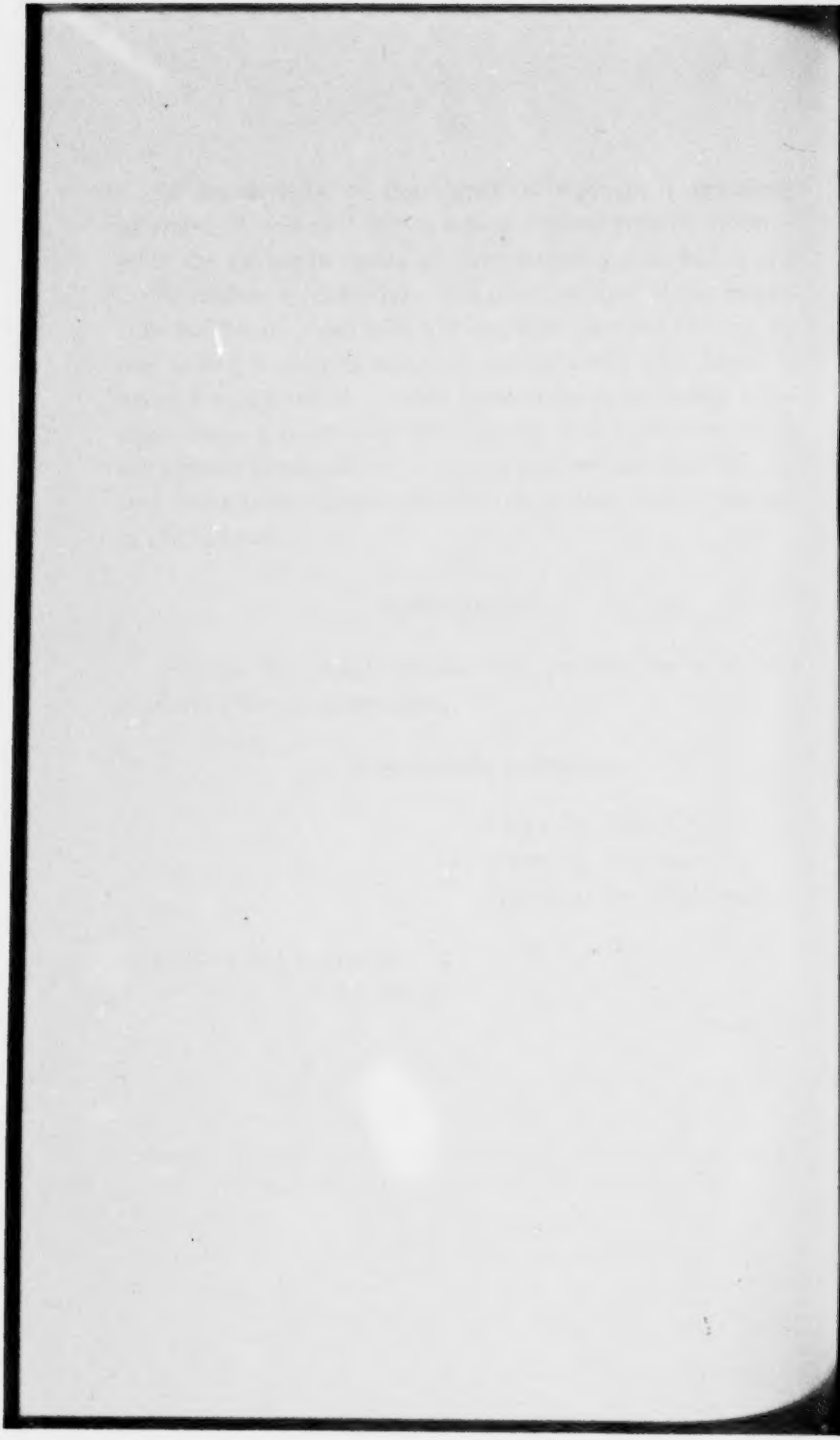

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APPENDIX A

United States Court of Appeals

FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 26th day of January, 1955.

Present:

HON. CHARLES E. CLARK
HON. THOMAS W. SWAN
HON. JEROME N. FRANK,
Circuit Judges

JANE PERLMAN, *et al.*,
Plaintiffs-Appellants,
and
HARRY MERNOFF,
Plaintiff-Intervenor,
—against—
C. RUSSELL FELDMANN, *et al.*,
Defendants-Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF CONNECTICUT

This cause came on to be heard on the transcript of record from the United States District Court for the District of Connecticut, and was argued by Counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed and the action is remanded for further proceedings in accordance with the opinion of this Court; with costs to the Appellants.

It is further ordered that a mandate issue to the said District Court in accordance with this decree.

A. DANIEL FUSARO
Clerk.

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United States Court of Appeals

FOR THE SECOND CIRCUIT

No. 9, October Term, 1954.

Argued October 5, 6, 1954 Decided January 26, 1955

JANE PERLMAN *et al.*,
Plaintiffs-Appellants,

v.

C. RUSSELL FELDMANN, NEWPORT STEEL CORPORATION *et al.*,
Defendants-Appellees.

Docket No. 22918

Before CLARK, Chief Judge, and SWAN and FRANK, Circuit Judges.

Appeal from the United States District Court for the District of Connecticut, Carroll C. Hincks, Judge.

Plaintiffs, Jane Perlman and others, appeal from the dismissal of their stockholders' derivative action to compel accounting and restitution of profits derived by former controlling stockholders and directors from the sale of stock of Newport Steel Corporation. Judgment reversed and action remanded for further accounting.

Eugene Eisenmann, New York City (Pomerantz, Levy & Haudek, Proskauer, Rose, Goetz & Mendelsohn, Nemerov & Shapiro, William Rosenfeld, Albraham L. Pomerantz, J. Alvin Van Bergh, William E. Haudek, A. Charles Lawrence, and Alan J. Altheimer, New York City, on the brief), for plaintiffs-appellants.

Arthur H. Dean, New York City (Sullivan & Cromwell, Howard T. Milman, Edward M. Harris, Jr., and Karl G. Harr, Jr., New York City, and Cummings & Lockwood and Raymond E. Hackett, Stamford, Conn., on the brief), for defendants-appellees C. Russell Feldmann et al.

William J. Harnisch, New York City, for defendant-appellee Newport Steel Corp.

CLARK, Chief Judge.

This is a derivative action brought by minority stockholders of Newport Steel Corporation to compel accounting for, and restitution of, allegedly illegal gains which accrued to defendants as a result of the sale in August, 1950, of their controlling interest in the corporation. The principal defendant, C. Russell Feldmann, who represented and acted for the others, members of his family,[1] was at that time not only the dominant stockholder, but also the chairman of the board of directors and the president of the corporation. Newport, an Indiana corporation, operated mills for the production of steel sheets for sale to manufacturers of steel products, first at Newport, Kentucky, and later also at other places in Kentucky and Ohio. The buyers, a syndicate organized as Wilport Company, a Delaware corporation, consisted of end-users of steel who were interested in securing a source of supply in a market becoming ever tighter in the Korean War. Plaintiffs contend that the consideration paid for the stock included compensation for

[1]The stock was not held personally by Feldmann in his own name, but was held by the members of his family and by personal corporations. The aggregate of stock thus had amounted to 33% of the outstanding Newport stock and gave working control to the holder. The actual sale included 55,552 additional shares held by friends and associates of Feldmann, so that a total of 37% of the Newport stock was transferred.

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the sale of a corporate asset, a power held in trust for the corporation by Feldmann as its fiduciary. This power was the ability to control the allocation of the corporate product in a time of short supply, through control of the board of directors; and it was effectively transferred in this sale by having Feldmann procure the resignation of his own board and the election of Wilport's nominees immediately upon consummation of the sale.

The present action represents the consolidation of three pending stockholders' actions in which yet another stockholder has been permitted to intervene. Jurisdiction below was based upon the diverse citizenship of the parties. Plaintiffs argue here, as they did in the court below, that in the situation here disclosed the vendors must account to the nonparticipating minority stockholders for that share of their profit which is attributable to the sale of the corporate power. Judge Hincks denied the validity of the premise, holding that the rights involved in the sale were only those normally incident to the possession of a controlling block of shares, with which a dominant stockholder, in the absence of fraud or foreseeable looting, was entitled to deal according to his own best interests. Furthermore, he held that plaintiffs had failed to satisfy their burden of proving that the sales price was not a fair price for the stock per se. Plaintiffs appeal from these rulings of law which resulted in the dismissal of their complaint.

The essential facts found by the trial judge are not in dispute. Newport was a relative newcomer in the steel industry with predominantly old installations which were in the process of being supplemented by more modern facilities. Except in times of extreme shortage Newport was not in a position to compete profitably with other steel mills for customers not in its immediate geographical area. Wilport, the purchasing syndicate, consisted of geographi-

cally remote end-users of steel who were interested in buying more steel from Newport than they had been able to obtain during recent periods of tight supply. The price of $20 per share was found by Judge Hincks to be a fair one for a control block of stock, although the over-the-counter market price had not exceeded $12 and the book value per share was $17.03. But this finding was limited by Judge Hincks' statement that "[w]hat value the block would have had if shorn of its appurtenant power to control distribution of the corporate product, the evidence does not show." It was also conditioned by his earlier ruling that the burden was on plaintiffs to prove a lesser value for the stock.

Both as director and as dominant stockholder, Feldmann stood in a fiduciary relationship to the corporation and to the minority stockholders as beneficiaries thereof. *Pepper* v. *Litton*, 308 U. S. 295; *Southern Pac. Co.* v. *Bogert*, 250 U. S. 483. His fiduciary obligation must in the first instance be measured by the law of Indiana, the state of incorporation of Newport. *Rogers* v. *Guaranty Trust Co. of New York*, 288 U. S. 123, 136; *Mayflower Hotel Stockholders Protective Committee* v. *Mayflower Hotel Corp.*, D. C. Cir., 193 F. 2d 666, 668. Although there is no Indiana case directly in point, the most closely analogous one emphasizes the close scrutiny to which Indiana subjects the conduct of fiduciaries when personal benefit may stand in the way of fulfillment of trust obligations. In *Schemmel* v. *Hill*, 91 Ind. App. 373, 169 N. E. 678, 682, 683, McMahan, J., said: "Directors of a business corporation act in a strictly fiduciary capacity. Their office is a trust. *Stratis* v. *Andreson* (1926) 254 Mass. 536, 150 N. E. 832, 44 A. L. R. 567; *Hill* v. *Nisbet* (1885) 100 Ind. 341, 353. When a director deals with his corporation, his acts will be closely scrutinized. *Bossert* v. *Geis* (1914) 57 Ind. App. 384, 107 N. E. 95. Directors of a corporation are its agents,

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and they are governed by the rules of law applicable to other agents, and, as between themselves and their principal, the rules relating to honesty and fair dealing in the management of the affairs of their principal are applicable. They must not, in any degree, allow their official conduct to be swayed by their private interest, which must yield to official duty. *Leader Publishing Co.* v. *Grant Trust Co.* (1915) 182 Ind. 651, 108 N. E. 121. In a transaction between a director and his corporation, where he acts for himself and his principal at the same time in a matter connected with the relation between them, it is presumed, where he is thus potential on both sides of the contract, that self-interest will overcome his fidelity to his principal, to his own benefit and to his principal's hurt." And the judge added: "Absolute and most scrupulous good faith is the very essence of a director's obligation to his corporation. The first principal duty arising from his official relation is to act in all things of trust wholly for the benefit of his corporation."

In Indiana, then, as elsewhere, the responsibility of the fiduciary is not limited to a proper regard for the tangible balance sheet assets of the corporation, but includes the dedication of his uncorrupted business judgment for the sole benefit of the corporation, in any dealings which may adversely affect it. *Young* v. *Higbee Co.*, 324 U. S. 204; *Irving Trust Co.* v. *Deutsch*, 2 Cir., 73 F. 2d 121, certiorari denied 294 U. S. 708; *Seagrave Corp.* v. *Mount*, 6 Cir., 212 F. 2d 389; *Meinhard* v. *Salmon*, 249 N. Y. 458, 164 N. E. 545, 62 A. L. R. 1; *Commonwealth Title Ins. & Trust Co.* v. *Seltzer*, 227 Pa. 410, 76 A. 77. Although the Indiana case is particularly relevant to Feldmann as a director, the same rule should apply to his fiduciary duties as majority stockholder, for in that capacity he chooses and controls the directors, and thus is held to have assumed their liability.

Pepper v. *Litton, supra,* 308 U. S. 295. This, therefore, is the standard to which Feldmann was by law required to conform in his activities here under scrutiny.

It is true, as defendants have been at pains to point out, that this is not the ordinary case of breach of fiduciary duty. We have here no fraud, no misuse of confidential information, no outright looting of a helpless corporation. But on the other hand, we do not find compliance with that high standard which we have just stated and which we and other courts have come to expect and demand of corporate fiduciaries. In the often-quoted words of Judge Cardozo: "Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions." *Meinhard* v. *Salmon, supra,* 249 N. Y. 458, 464, 164 N. E. 545, 62 A. L. R. 1. The actions of defendants in siphoning off for personal gain corporate advantages to be derived from a favorable market situation do not betoken the necessary undivided loyalty owed by the fiduciary to his principal.

The corporate opportunities of whose misappropriation the minority stockholders complain need not have been an absolute certainty in order to support this action against Feldmann. If there was possibility of corporate gain, they are entitled to recover. In *Young* v. *Higbee Co., supra,* 324 U. S. 204, two stockholders appealing the confirmation of a plan of bankruptcy reorganization were held liable for

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profits received for the sale of their stock pending determination of the validity of the appeal. They were held accountable for the excess of the price of their stock over its normal price, even though there was no indication that the appeal could have succeeded on substantive grounds. And in *Irving Trust Co.* v. *Deutsch, supra,* 2 Cir., 73 F. 2d 121, 124, an accounting was required of corporate directors who bought stock for themselves for corporate use, even though there was an affirmative showing that the corporation did not have the finances itself to acquire the stock. Judge Swan speaking for the court pointed out that "The defendants' argument, contrary to *Wing* v. *Dillingham* [5 Cir., 239 F. 54], that the equitable rule that fiduciaries should not be permitted to assume a position in which their individual interests might be in conflict with those of the corporation can have no application where the corporation is unable to undertake the venture, is not convincing. If directors are permitted to justify their conduct on such a theory, there will be a temptation to refrain from exerting their strongest efforts on behalf of the corporation since, if it does not meet the obligations, an opportunity of profit will be open to them personally."

This rationale is equally appropriate to a consideration of the benefits which Newport might have derived from the steel shortage. In the past Newport had used and profited by its market leverage by operation of what the industry had come to call the "Feldmann Plan." This consisted of securing interest-free advances from prospective purchasers of steel in return for firm commitments to them from future production. The funds thus acquired were used to finance improvements in existing plants and to acquire new installation. In the summer of 1950 Newport had been negotiating for cold-rolling facilities which it needed for a more fully integrated operation and a more marketable product, and

Feldmann plan funds might well have been used toward this end.

Further, as plaintiffs alternatively suggest, Newport might have used the period of short supply to build up patronage in the geographical area in which it could compete profitable even when steel was more abundant. Either of these opportunities was Newport's, to be used to its advantage only. Only if defendants had been able to negate completely any possibility of gain by Newport could they have prevailed. It is true that a trial court finding states: "Whether or not, in August, 1950, Newport's position was such that it could have entered into 'Feldmann Plan' type transactions to procure funds and financing for the further expansion and integration of its steel facilities and whether such expansion would have been desirable for Newport, the evidence does not show." This, however, cannot avail the defendants, who—contrary to the ruling below—had the burden of proof on this issue, since fiduciaries always have the burden of proof in establishing the fairness of their dealings with trust property. *Pepper* v. *Litton, supra,* 308 U. S. 295; *Geddes* v. *Anaconda Copper Mining Co.,* 254 U. S. 590; *Mayflower Hotel Stockholders Protective Committee* v. *Mayflower Hotel Corp.*, D. C. Cir., 173 F. 2d 416.

Defendants seek to categorize the corporate opportunities which might have accrued to Newport as too unethical to warrant further consideration. It is true that reputable steel producers were not participating in the gray market brought about by the Korean War and were refraining from advancing their prices, although to do so would not have been illegal. But Feldmann plan transactions were not considered within this self-imposed interdiction; the trial court found that around the time of the Feldmann sale Jones & Laughlin Steel Corporation, Republic Steel Company, and Pittsburgh Steel Corporation were all partici-

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pating in such arrangements. In any event, it ill becomes the defendants to disparage as unethical the market advantages from which they themselves reaped rich benefits.

We do not mean to suggest that a majority stockholder cannot dispose of his controlling block of stock to outsiders without having to account to his corporation for profits or even never do this with impunity when the buyer is an interested customer, actual or potential, for the corporation's product. But when the sale necessarily results in a sacrifice of this element of corporate good will and consequent unusual profit to the fiduciary who has caused the sacrifice, he should account for his gains. So in a time of market shortage, where a call on a corporation's product commands an unusually large premium, in one form or another, we think it sound law that a fiduciary may not appropriate to himself the value of this premium. Such personal gain at the expense of his co-ventures seems particularly reprehensible when made by the trusted president and director of his company. In this case the violation of duty seems to be all the clearer because of this triple role in which Feldmann appears, though we are unwilling to say, and are not to be understood as saying, that we should accept a lesser obligation for any one of his roles alone.

Hence to the extent that the price received by Feldmann and his co-defendants included such a bonus, he is accountable to the minority stockholders who sue here. Restatement, Restitution §§ 190, 197 (1937); *Seagrave Corp.* v. *Mount, supra,* 6 Cir., 212 F. 2d 389. And plaintiffs, as they contend, are entitled to a recovery in their own right, instead of in right of the corporation (as in the usual derivative actions), since neither Wilport nor their successors in interest should share in any judgment which may be rendered. See *Southern Pacific Co.* v. *Bogert,* 250 U. S. 483. Defendants cannot well object to this form of recovery, since the only alter-

native, recovery for the corporation as as whole, would subject them to a greater total liability.

The case will therefore be remanded to the district court for a determination of the question expressly left open below, namely, the value of defendants' stock without the appurtenant control over the corporation's output of steel. We reiterate that on this issue, as on all others relating to a breach of fiduciary duty, the burden of proof must rest on the defendants. *Bigelow* v. *RKO Radio Pictures,* 327 U. S. 251, 265-266; *Package Closure Corp.* v. *Sealright Co.,* 2 Cir., 141 F. 2d 972, 979 (2d Cir. 1944). Judgment should go to these plaintiffs and those whom they represent for any premium value so shown to the extent of their respective stock interests.

The judgment is therefore reversed and the action remanded for further proceedings pursuant to this opinion.

SWAN, Circuit Judge, dissenting:

With the general principles enunciated in the majority opinion as to the duties of fiduciaries I am, of course, in thorough accord. But, as Mr. Justice Frankfurter stated in *Securities and Exchange Com.* v. *Chenery Corp.,* 318 U. S. 80, 85, "to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations?" My brothers' opinion does not specify precisely what fiduciary duty Feldmann is held to have violated or whether it was a duty imposed upon him as the dominant stockholder or as a director of Newport. Without such specification I think that both the legal profession and the business world will find the decision confusing and will be unable to foretell the extent of its impact upon customary practices in the sale of stock.

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The power to control the management of a corporation, that is, to elect directors to manage its affairs, is an inseparable incident to the ownership of a majority of its stock, or sometimes, as in the present instance, to the ownership of enough shares, less than a majority, to control an election. Concededly a majority or dominant shareholder is ordinarily privileged to sell his stock at the best price obtainable from the purchaser. In so doing he acts on his own behalf, not as an agent of the corporation. If he knows or has reason to believe that the purchaser intends to exercise to the detriment of the corporation the power of management acquired by the purchase, such knowledge or reasonable suspicion will terminate the dominant shareholder's privilege to sell and will create a duty not to transfer the power of management to such purchaser. The duty seems to me to resemble the obligation which everyone is under not to assist another to commit a tort rather than the obligation of a fiduciary. But whatever the nature of the duty, a violation of it will subject the violator to liability for damages sustained by the corporation. Judge Hincks found that Feldmann had no reason to think that Wilport would use the power of management it would acquire by the purchase to injure Newport, and that there was no proof that it ever was so used. Feldmann did know, it is true, that the reason Wilport wanted the stock was to put in a board of directors who would be likely to permit Wilport's members to purchase more of Newport's steel than they might otherwise be able to get. But there is nothing illegal in a dominant shareholder purchasing from his own corporation at the same prices it offers to other customers. That is what the members of Wilport did, and there is no proof that Newport suffered any detriment therefrom.

My brothers say that "the consideration paid for the stock included compensation for the sale of a corporate

asset", which they describe as "the ability to control the allocation of the corporate product in a time of short supply, through the control of the board of directors; and it was effectively transferred in this sale by having Feldmann procure the resignation of his own board and the election of Wilport's nominees immediately upon comsummation of the sale." The implications of this are not clear to me. If it means that when market conditions are such as to induce users of a corporation's product to wish to buy a controlling block of stock in order to be able to purchase part of the corporation's output at the same mill list prices as are offered to other customers, the dominant stockholder is under a fiduciary duty not to sell his stock, I cannot agree. For reasons already stated, in my opinion Feldmann was not proved to be under any fiduciary duty as a stockholder not to sell the stock he controlled.

Feldmann was also a director of Newport. Perhaps the quoted statement means that as a director he violated his fiduciary duty in voting to elect Wilport's nominees to fill the vacancies created by the resignations of the former directors of Newport. As a director Feldmann was under a fiduciary duty to use an honest judgment in acting on the corporation's behalf. A director is privileged to resign, but so long as he remains a director he must be faithful to his fiduciary duties and must not make a personal gain from performing them. Consequently, if the price paid for Feldmann's stock included a payment for voting to elect the new directors, he must account to the corporation for such payment, even though he honestly believed that the men he voted to elect were well qualified to serve as directors. He can not take pay for performing his fiduciary duty. There is no suggestion that he did do so, unless the price paid for his stock was more than its value. So it seems to me that decision must turn on whether finding 120 and con-

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clusion 5 of the district judge are supportable on the evidence. They are set out in the margin.[1]

Judge Hincks went into the matter of valuation of the stock with his customary care and thoroughness. He made no error of law in applying the principles relating to valuation of stock. Concededly a controlling block of stock has greater sale value than a small lot. While the spread between $10 per share for small lots and $20 per share for the controlling block seems rather extraordinarily wide, the $20 valuation was supported by the expert testimony of Dr. Badger, whom the district judge said he could not find to be wrong. I see no justification for upsetting the valuation as clearly erroneous. Nor can I agree with my brothers that the $20 valuation "was limited" by the last sentence in finding 120. The controlling block could not by any possibility be shorn of its appurtenant power to elect directors and through them to control distribution of the corporate product. It is this "appurtenant power" which gives a controlling block its value as such block. What evidence could be adduced to show the value of the block "if shorn" of such appurtenant power, I cannot conceive, for it cannot be shorn of it.

The opinion also asserts that the burden of proving a lesser value than $20 per share was not upon the plaintiffs but the burden was upon the defendants to prove that the stock was worth that value. Assuming that this might be

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[1] "120. The 398,927 shares of Newport stock sold to Wilport as of August 31, 1950, had a fair value as a control block of $20 per share. What value the block would have had if shorn of its appurtenant power to control distribution of the corporate product, the evidence does not show."

"5. Even if Feldmann's conduct in cooperating to accomplish a transfer of control to Wilport immediately upon the sale constituted a breach of a fiduciary duty to Newport, no part of the moneys received by the defendants in connection with the sale constituted profits for which they were accountable to Nepwort."

true as to the defendants who were directors of Newport, they did show it, unless finding 120 be set aside. Furthermore, not all the defendants were directors; upon what theory the plaintiffs should be relieved from the burden of proof as to defendants who were not directors, the opinion does not explain.

The final conclusion of my brothers is that the plaintiffs are entitled to recover in their own right instead of in the right of the corporation. This appears to be completely inconsistent with the theory advanced at the outset of the opinion, namely, that the price of the stock "included compensation for the sale of a corporate asset." If a corporate asset was sold, surely the corporation should recover the compensation received for it by the defendants. Moreover, if the plaintiffs were suing in their own right, Newport was not a proper party. The case of *Southern Pacific* v. *Bogert,* 250 U. S. 483, relied upon as authority for the conclusion that the plaintiffs are entitled to recover in their own right, relates to a situation so different that the decision appears to me to be inapposite.

I would affirm the judgment on appeal.

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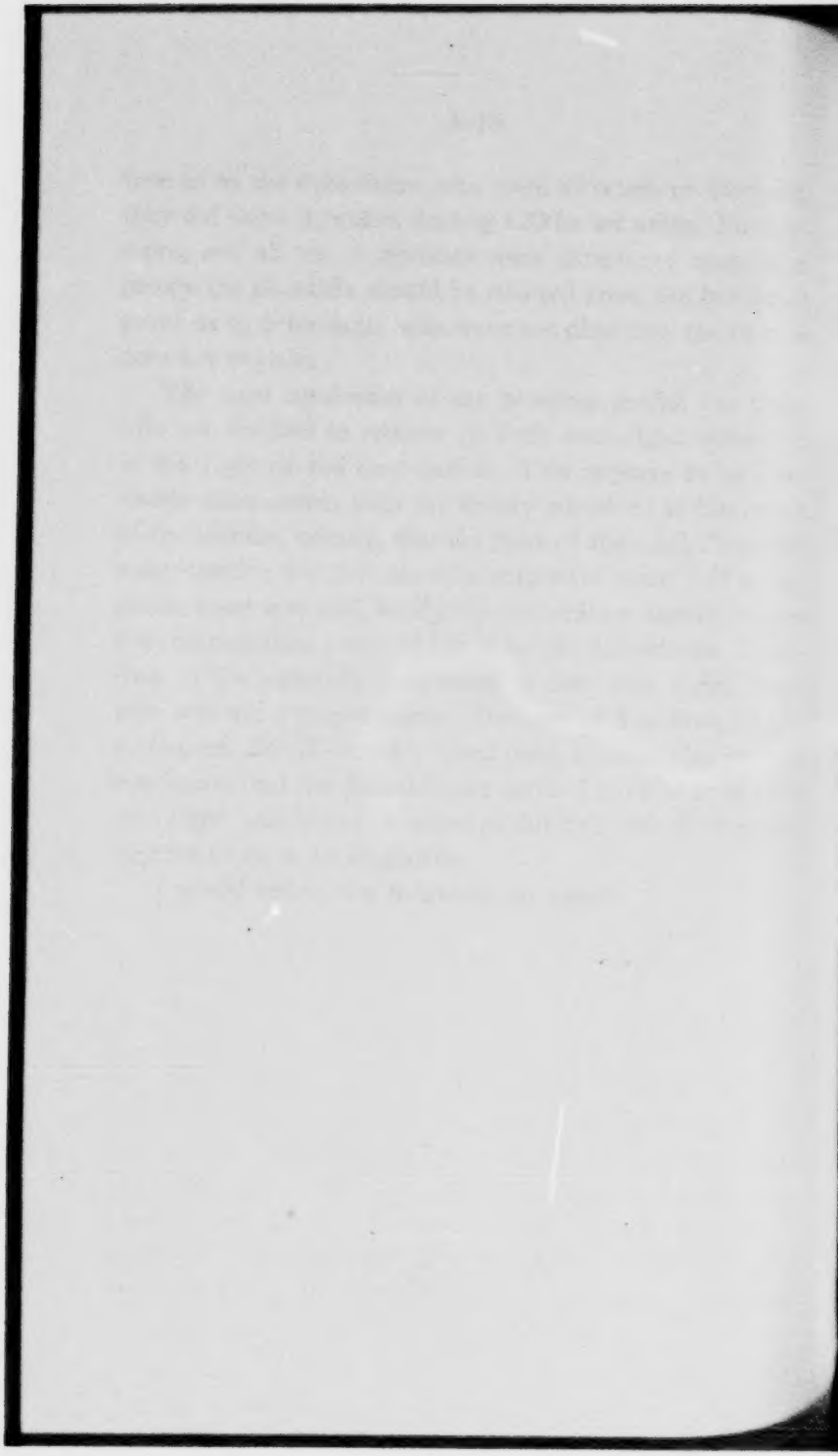

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UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

JANE PERLMAN, *et al.*, *Plaintiffs*, and HARRY MERNOFF, *Plaintiff-Intervenor*, v. C. RUSSELL FELDMANN, *et al.*	Civil Action No. 3086

OPINION

This is a derivative action commenced by certain of the minority shareholders of the Newport Steel Corporation, an Indiana corporation hereinafter referred to as "Newport" engaged in the production of steel. The principal point at issue, under the pleadings and arguments of the parties, is as to the right of the defendant C. Russell Feldmann (hereinafter called "Feldmann") and a group of friends and associates to retain the sum of $7,978,540. which was received in connection with the sale of 398,927 shares of Newport stock—311,000 of which were the property of companies controlled by Feldmann—to the Wilport Corporation on August 31, 1950, at $20 a share. At the time Feldmann had control of the largest block of Newport stock and was its chief executive officer and a director. The stock sold comprised 37% of the Newport stock outstanding and carried with it working control of Newport. The Wilport Corporation is a Delaware corporation formed by a group of end-users of steel for the express purpose of acquiring and holding a control block of Newport stock. Aside from

Feldmann and Newport, the defendants in the action are all members of Feldmann's family who joined with him in putting together the block of stock which was sold to Wilport.

It is the plaintiff's claim that the sale of stock, with an accompanying transfer of Newport's corporate offices to Wilport's nominees, constituted a breach of Feldmann's fiduciary duties to the corporation which resulted in "profits" to the defendants for which they are accountable to Newport. And to understand what the plaintiffs mean by "profits" in the context of this case one must have in mind that the challenged transaction occurred some time after our national entrance into the Korean enterprise as a result of which there was a "short" or "gray" market in steel. In that situation steel producers were in a position to exact for their products from hungry end-users of steel a price premium over and above prices fixed on the basis of mill costs. There was then no "black" market because at the time sales at a premium were not illegal. There was, however, a "gray" market in which sales were made at premiums. This market, out of patriotic considerations, reputable producers (and so far as the record shows Newport qualified for this classification) declined to enter: without legal compulsion they agreed to forego their advantage and to sell at not above posted prices which tied in with their respective mill costs. The plaintiffs say they have no criticism of Feldmann's management of Newport for its self-restraint in this respect. But they contend that, since Feldmann's sale of a control block was to a group of end-users of steel, who were thus enabled to divert Newport's production to themselves, at a price allegedly in excess of the value of the stock but for the effect of the gray market, this excess of value which was covered into the purchase price received by Feldmann (and his associates) was in effect a gray market premium and

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constituted a "profit" on a "corporate asset" wrongfully diverted from the corporation into Feldmann's individual pocket.

The defendants deny that there has been a breach of any duty owed to Newport. It is their position that the transaction in question was merely a sale of a block of stock with the rights and powers attaching thereto. They assert also that if any of Feldmann's acts as an officer or director are in issue, these acts were ratified by vote of the shareholders at Newport's annual meeting on February 19, 1951 and therefore cannot now be made the basis of an action by the corporation.

On analysis it will be seen that the basic question in the case is one of law. In the state of the steel market as it existed on August 31, 1950, was the admitted power inherent in a control block of corporate stock to control the distribution of Newport's product and to select those who may become its customers a corporate asset as the plaintiffs contend, or was it something properly pertaining to the ownership of a control block of stock the value of which was necessarily and properly reflected in the value of the stock as the defendants contend? I turn directly to a discussion of this central issue.

When the distribution of a corporate stock is such that as a practical matter under the corporate charter and by-laws a given block—whether a majority block or one somewhat less—can control the election of the directors, the power is one that may be utilized to control the corporate management. This power of control, it should be remembered, springs from the electoral power of the stock. By the very nature of its origin, its only existence is as an adjunct of the stock: it is not the subject-matter of separate sale in any or all of its specific applications. It is obvious, I think, that some at least of the specific applications of

the power have inherent value effective to enhance the value of a control block of the stock.

For instance, to the usual minority stockholder in a corporation the value of his stock necessarily depends on earnings which in turn depend on the abilities of its management. But one considering the purchase of a control block in a corporation may give less weight to past earnings since, if a change in management might be beneficial, the power to make such a change is in his hands. Thus, where the purchaser feels that the corporation's past record does not adequately reflect its realizable possibilities, he may well feel justified in paying more than the quoted market price for a control block of its stock, on the theory that the present price probably has been determined in large measure by the corporate earnings under the old management. Surely this power through stock control to improve the corporate performance may be a factor of value attaching to a control block of stock.

Turning to another specific application of the power of corporate control it is apparent that under normal conditions such power as management has to select customers for the corporate product is not generally a factor of substantial value. However, where—as here—because of imbalance between supply and demand the corporation cannot supply all who are eager to become customers, it is obvious, I think, that the power to control the selection of the customers is a factor adding materially to the value of the block of stock to which the power is appurtenant. It is another one of the incidents of the electoral power of stock which contributes value to the entire bundle of rights and powers which is wrapped in a control block of stock.

Where a stockholder has power through his control of management to control distribution of the corporate prod-

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uct, whether he exercises his power or leaves it in abeyance, or whether he transfers it with his stock to another, the corporate balance sheet is not thereby affected. To view the power in management, or in a stockholder through his control over management, to select the customers of the company as a corporate asset in itself, is to indulge in a confusion of thinking which would introduce unsettling confusion throughout the world of commerce. For the power to select customers if an asset is one having value only because it carries ability to command a premium price for the corporate product—a condition obtaining only in a seller's market when demand exceeds supply: in a buyer's market no such condition exists. What chaos would ensue if a corporate balance sheet to have precise definition required adjustment for every shift in the balance between supply and demand—and if, to determine the rights of a corporation vis-a-vis a particular stockholder, it were necessary to determine not only the balance between demand and supply for the corporate product but also whether the particular block of stock involved, considered for its relation to the current distribution of all the stock, carried practical control of the corporation!

The plaintiffs' repeatedly expressed assumption that in the situation here the power to control the corporate distribution was a *corporate asset* is scarcely consistent with their prayer that the defendants be required to pay over the consideration therefor not to the corporation for the benefit of all stockholders but instead to stockholders exclusive of Wilport, the largest stockholder of all. Nor is such an assumption supported either by citation of authority or by reason. Even assuming that the price received by Feldmann reflected the value of the power to control distribution of the corporate product, it is fallacious to argue that the sale cloaked a gray market transaction whereby Feldmann, whose

management led Newport to forego premium prices on its product which it might have obtained for the benefit of all stockholders, obtained individually the equivalent of a price premium in capitalized form for the benefit only of the minority stockholders who owned the control block. If members of the Wilport group in gray market transactions had merely bought steel from Newport at a premium they would have remained free from responsibility for producing steel and all the hazards which attend the steel industry. Instead, by a capital investment they made a long-range commitment to the production of steel and accepted the attendant vicissitudes. This feature of the transaction takes it outside the gray market. Their initial investment presumably contributed less to the restoration of balance between supply and demand than would have resulted from a commitment of capital to new production facilities. But there was nothing in the law or the business practice at the time which extended the prohibition against "gray market" premium purchases of the end-product to the purchase of production facilities. Indeed, restrictions on the sale of basic production facilities thereby freezing the committed capital, would obviously tend to obstruct the achievement of balance between supply and demand by discouraging investment in new sources of supply. But even if, contrary to my view, it was unethical under the circumstances for Feldmann to sell his stock and for Wilport to buy it, it does not follow that a corporate asset was involved.

I hold that the power to control the distribution of the product is not an asset of the corporation. The power, irrespective of its value in a particular case, is a direct attribute of management and an indirect attribute of a control block of stock. It thus may constitute an additional factor of value attaching to the control block, which enures to the

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benefit of its owner and may be realized by him on its sale. *Levy* v. *American Beverage Corp.*, 265 App. Div. 208, 38 N. Y. S. 2d 517, 526; *Stanton* v. *Schenck,* 251 N. Y. S. 221, 233; *Mayflower Hotel Stock P.C.* v. *Mayflower Hotel Corp.*, 173 F. 2d 416; *Hauben* v. *Morris,* 5 N. Y. S. 2d 721; affm'd 281 N. Y. 652, 22 N. E. 2d 482; and *Roby* v. *Dunnett,* 88 F. 2d 68.

From this it follows that the price received is not invalidated as evidence of value merely because it reflects the value of the power to control distribution. And here there is no evidence of circumstances surrounding the sale, such as fraud, duress, mistake, etc., which if present would destroy or impair the probative effect of price received as evidence of value. That being so, the evidence of an actual price, determined by the process of arm's-length negotiations as to the value of a control block between informed parties—the principal seller having long been the active, responsible, executive of the business and the buyers being a group which had made a painstaking investigation of all phases of the business and had had the benefit of expert advice of its own choosing—is by far the most convincing evidence as to value in the record. Certainly its reliability far exceeds the opinion testimony of any of the experts, or price quotations for small lots. The defendants are thus entitled to a dismissal because a great preponderance of the evidence shows that each received no more than a pro rata share of the fair value of the block sold.

The simple holding just indicated is decisive of the case, as will be apparent when one examines its impact on every position taken by the plaintiffs. To that task I now turn.

The plaintiffs contend that Feldmann, both as the controlling stockholder and also as an executive officer and director of the corporation, violated some fiduciary duty

and thereby either caused harm to the corporation, or regardless of harm to the corporation, secured a profit for himself and his co-defendants for which the defendants are accountable.

Consider first the plaintiff's charge of breach of fiduciary duty by Feldmann, in view of his position as the dominant, controlling stockholder. If the power to control distribution of the corporate product was a corporate asset, to the extent that the sale price included the value of this power the defendant sold and received payment for a corporate asset. For minority stockholders thus to realize personally on a corporate asset would obviously constitute a breach of fiduciary duty. If, however, as I hold, the power in question is not a corporate asset, the transfer of the power could not constitute a conversion of corporate property and there was no breach of fiduciary duty which was based upon a claimed conversion.

But the plaintiffs contend that the sale was a breach of Feldmann's fiduciary duty because the resulting transfer of control was likely to injure the corporation as Feldmann should have known. For this contention, the facts of the case provide no basis. There was no evidence of intent or effort on the part of the old management or the new to jettison old and valued customers or to sell the corporate product to the members of the Wilport group *at a favored price less than the posted mill price.* Feldmann's testimony that end-users of steel, if stockholders with a voice in Newport's management, might be expected to constitute a source of strength, not harm, to Newport when the sellers' market should give way to a buyers' market, sounded highly plausible to me. However that may be, there is no direct evidence, nor do the facts leave room for fair inference, that Newport would be better off if it were to sell to X, Y or Z than to the members of the Wilport group or indeed that

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it had been harmed, or would be harmed, by the modified distribution of Newport output under the new management.

Nor did the evidence show that the defendants, in order to realize on the power to control distribution of output, injured the corporation by selling control to irresponsible persons lacking in manufacturing experience and business acumen who might have been expected to discharge or who, since the sale, have in fact discharged the managerial function with less than reasonable efficiency. Such evidence on the point as there is points in just the opposite direction. Whether the new management is as effective as the old, it is not necessary to decide: when a controlling stockholder wants to sell, nothing in the law requires him to defer action until he can find a purchaser of at least equal ability to assume the responsibilities of control.

Nor in my view did plaintiffs succeed in proving harm to Newport resulting from a failure of a merger with Follansbee on possible terms advantageous to Newport. Certainly the geographical separation between the Newport and Follansbee mills was a factor seriously unfavorable to a merger. Anyhow, there is nothing to show that Feldmann's sale prevented a merger: if, indeed, a merger was possible on favorable terms before August 31, 1950,—a fact in my judgment not proved—so far as appears it was equally possible after that date.

Nor was the sale shown to have deprived Newport of any loss of opportunity to benefit from further applications of the so-called "Feldmann Plan". This was a financing technique, first developed by the defendant Feldmann, whereby end-users of steel furnished capital for new facilities taking as part consideration for their loans commitments upon the output of the new production facilities. The plan had been used several times to expand Newport's

facilities in the past, on the whole with great success although at times successful results had been problematical due to the inherent hazards of expansion in these uncertain times. However, there is no evidence here which proves that in 1950 financing under the Feldmann Plan was possible or, if so, that it would have been advisable for Newport to expand even with the aid of such financing. And here again it must not be forgotten that if in 1950 expansion was indeed desirable the use of the Feldmann Plan was as available to the new management as to the old. The Plan had been covered neither by copyright nor patent!

In this connection let me record my concurrence with plaintiffs' assertion that a corporate officer may be held accountable for wrongfully depriving his corporation of a business opportunity without proof that the opportunity, if availed of by the corporation, would have been successful. But before such a doctrine can come into play, there must at least be plain proof of the existence of an opportunity. Thus in the cases which the plaintiffs cite on this point there was evidence that the defendant had taken over a piece of property, as in *Meinhard* v. *Salmon,* 249 N. Y. 458, 164 N. E. 545 (1928), *Irving Trust Co.* v. *Deutsch,* 73 F. 2d 121 (CCA 2, 1934) cert. den. 294 U. S. 709, and *Pratt* v. *Shell Petroleum Corp.,* 100 F. 2d 833 (CCA 10, 1938), or a business, as in *Loft, Inc.* v. *Guth,* 23 Del. Ch. 138, 2 A. 2d 225 (1938), 323 Mass. 187, 80 N. E. 2d 522, (1948), which he should have offered to his cestui, the corporation. There is nothing in the evidence here to satisfy this basic requirement of the doctrine invoked.

But the plaintiffs go further and charge that Feldmann breached his fiduciary duties not merely by selling the stock but also by making wrongful use of his official corporate responsibilities without which, it is charged, a sale at a price

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as high as $20 would have been impossible. In this connection they point to the undisputed evidence that Feldmann contemporaneously with the sale called a meeting of the Newport directors at which by Feldmann's instigation all the old Newport directors successively resigned, the last so to resign being himself, and the vacancies thus created were successively filled with nominees of the Wilport group. The claim is that to facilitate a sale to his own personal advantage he misused his power as a dominant officer of the corporation; that for his personal gain he sold the Newport directorships and thereby, without the authority of a stockholders' meeting, accomplished an immediate transfer of the power to control the distribution of the corporate product. Defendants' counsel have argued that Feldmann's official cooperation in thus accomplishing a forthwith transfer of control was not a condition of the sale and that no part of the price paid was consideration for an agreement for the immediate transfer of control. This conflict as to the proper inference to be drawn I have resolved in favor of the plaintiffs (Finding 64) and have found that there was at least an informal agreement that the payment of the price should be accompanied with a forthwith transfer of control accomplished as above set forth.

Even so, I cannot sustain the plaintiff's contention that regardless of proof of harm done to the corporation Feldmann's conduct in thus cooperating to bring about a forthwith transfer of control constituted a breach of fiduciary duty. After all, Feldmann's act merely accelerated the transfer of control which the new owners of the control block would have accomplished at the next stockholders' meeting. So far as appears the procedure followed involved no direct violation of statute, or of the corporate charter

or bylaws. It was in keeping with the policy of the law which deems that the choice of management for a corporation is best vested in stockholders who have the greatest interest at stake. In my opinion, it would be quixotic and unrealistic to brand as a breach of trust conduct which was free from fraud or overreaching and was neither intended nor effective to cause the slightest harm either to the corporation or other stockholders. *Barnes* v. *Brown,* 80 N. Y. 527, 47 N. Y. S. 918; *Levy* v. *American Beverage Corp., supra; Stanton* v. *Schenck, supra; Mayflower Hotel Stock P. C.* v. *Mayflower Hotel Corp., supra; Hauben* v. *Morris, supra; Oil Shares, Inc.* v. *Kahn,* 94 F. 2d 751, rev'd on other grounds, 304 U. S. 551.

Cases which plaintiffs cite to a contrary effect are to be distinguished. In *Porter* v. *Healy,* 244 Pa. 427, 91 Atl. 428, the defendant directors, who were majority stockholders, in order to obtain for their stock more than their *pro rata* share of a purchase price offered for the entire outstanding stock, made affirmative misrepresentations in a letter to other stockholders, and apparently diverted to themselves a part of the consideration which but for their fraud would have been available *pro rata* to all stockholders. As I analyze the opinion, it was because of this fraud that the cooperation of the defendants in bringing about a forthwith change in control by resigning and electing new directors nominated by the purchaser was held to be a sale of their official positions and hence a breach of trust. Here there is no evidence of fraud or indeed of any detriment to other stockholders. Rather the evidence shows only that Feldmann, as an incident to his sale of a control block, cooperated in accelerating the incidental shift of control, thus avoiding even a temporary situation in which those responsible for management should be without any substantial stock interest.

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In *Gerdes* v. *Reynolds,* 28 N. Y. S. 2d 622, and *Ballantine* v. *Ferretti,* 28 N. Y. S. 2d 668, the court found compelling reasons—all absent here—for an inference that the forthwith change in management was brought about not as a proper incident to a sale of a control block but rather as an overt act in a conspiracy to defraud other stockholders and permit the looting of the corporation.

Nor is *Insuranshares Corp.* v. *Northern Fiscal Corp.,* 35 F. Supp. 22 apposite. There the defendant directors who sold their control block of stock to purchasers who sought and used the control thus gained to loot the corporation, were held liable because of negligence in failing to discover and prevent the contemplated fraud. Here there was no proof of such negligence on the part of Feldmann, no proof of intended fraud on the part of the purchasers, and no proof of looting or other harm to the corporation.

But even if Feldmann's conduct in this connection should be labelled as a breach of fiduciary duty, there is still absent an indispensable element in the plaintiff's case. There is no evidence whatever that through the breach Feldmann or his associated defendants derived profits for which they are accountable to the corporation. In this connection it must be remembered that the plaintiffs frankly are not seeking the recovery of damages for harm done to the corporation by a breach of trust. Instead, plaintiffs rely upon the principle that "a fiduciary who has acquired a benefit by a breach of his duty as fiduciary is under a duty of restitution to the beneficiary," quoting from the Restatement, Restitution, Sec. 138(1). But this principle must be read in the context of the opening sentence of the introductory note to the Chapter (Chap. 7, page 522) from which the quotation was taken. Thus construed, it is clear that only one who has lost his property (or services) may have "restitution" of them. The same principle is recognized in the Restate-

ment of Trusts, comment on Sec. 205(b), wherein it is stated that on a breach of trust "the trustee is chargeable with any profit made by him through the improper disposition or use *of trust property*" (emphasis supplied).

And so it is that the plaintiffs' claim of "profits" for which the defendants are accountable is valid in law only if the challenged transaction involved the transfer of a corporate asset. Thus, even if Feldmann, by cooperating in the immediate installation of the new board, committed a breach of trust, neither he nor the other defendants are accountable for any part of the price received on the sale of their stock unless they had used part of the trust corpus, that is to say, some corporate asset, in the accomplishment of the transaction. This, under my controlling holding, stated above, was not done: the transfer of the stock with its inseparable power of control did not involve the transfer of any corporate asset. It follows that an essential element of the plaintiffs' case is completely absent. And this conclusion is required whether the transfer of control to the Wilport group be found to have caused the corporation some harm or whether, as I appraise the evidence, no harm resulted. For in neither case did the defendants receive any profits for which they were accountable. If harm resulted, at most the resulting damages were recoverable and damages have not been proved or even claimed.

Thus in the view which I take of the case there is no need whatever to follow through the laborious process advocated by the plaintiffs, viz., to find by evidence other than the actual sale price the fair value of the block of stock apart from its inherent power to control distribution of product and then by subtracting the value thus ascertained from the amount received by the defendants arrive at a remainder figure which would represent the value of the power to control the distribution of the product. However,

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to make my findings sufficiently complete for purposes of possible appeal I have included findings on the subject-matter of value which I now supplement by the following discussion.

On the issue of value the plaintiffs offered the testimony of an expert witness, and also placed in evidence both over-the-counter quotations for the stock during the period in question and the sales prices of small lots, all tending to prove that the value was under $20 a share. The defendants, on their part, also offered the testimony of an expert witness whose opinion was favorable to them, with some other supporting evidence. Although the defendants contend that market quotations are of no effect where the value of a control block is to be determined as is the case here, I hold that such quotations may at least constitute some evidence of value. *Cf. Robertson* v. *Routzahn* (CCA 6, 1935) 75 F. 2d 537. At a minimum, they serve as a check on a result arrived at by the use of some more complicated method of valuation. Bonbright: The Valuation of Property, P. 244-9.

The plaintiffs' and the defendants' experts both testified to a valuation of the corporate stock by a method depending wholly or largely on a capitalization of what they considered to be the reasonably foreseeable earnings. As between the two "experts" I found the defendants' more worthy of credit. The plaintiffs' expert admittedly had never seen the corporate property and his information as to its facilities and business was clearly inadequate. His valuation method apparently gave little or no separate consideration to the corporation's properties other than its steel-producing facilities. Under the circumstances, I feel that his testimony, in so far as it consisted of an opinion as to the specific value of the stock, should be given no weight whatsoever.

The defendants' expert, on the other hand, exhibited a reasonably thorough knowledge of Newport's affairs. He had visited its steel-producing facilities and had been given free access to the corporate books. In his opinion, the stock sold to Wilport should be valued by first determining the value of Newport as an enterprise and then multiplying that figure by 37%—the per cent of the outstanding stock which the block sold to Wilport constituted. It was his position that because the block of stock was sufficiently large to give the holder control of the corporation, it should be valued as a proportionate part of the value of the whole business, and not on the basis of the value of the individual shares to a small investor. I agree.

UNIT VALUES

In arriving at a value for Newport as an enterprise, defendants' expert first valued each of its component elements and then added these separate valuations together to obtain a value for the whole. His unit valuations were as follows:

(1) THE DETROIT REALTY. The witness stated that he had valued the property both on the basis of a capitalization of its expected earnings under a lease to the government, which gave a result of $1,657,500, and also by computing the net return to Newport if the government should exercise its option under the lease, which gave a value of $1,073,658. He took the lower figure as the value as of August 31, 1950.

(2) THE UNIVERSAL COOLER DIVISION. This was valued at its book value as of August 31, 1950 or $2,718,051. The division was sold on October 31, 1950 for slightly more than its then book value and there had been no appreciable change in its situation during the intervening two months.

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(3) The Caswell-Runyan Division. This was valued on the basis of a capitalization of its earnings. The witness annualized the division's average monthly earnings for the ten months preceding August 31, 1950, deducted income taxes at the rate of 42% and multiplied the result by five. This gave a value of $2,018,400.

(4) The Steel Facilities Other Than the Pipe Mill. The witness stated both a maximum and a minimum value for these facilities. In arriving at his minimum value he first estimated separately the expected earnings, before the deduction of taxes and general expenses, of the old steel facilities and the new. His estimate for the old facilities was based upon the actual performance of these facilities during June, 1950. In the case of the new facilities, which were not yet in full operation, he determined the hypothetical profits for a "normal" month in the future by postulating a "normal" production for the facilities, multiplying that by the price per ton in effect in August, 1950 and subtracting therefrom expected "normal" monthly expenses, which he derived from estimates made by Newport officials during the summer of 1950. The monthly gross profit, arrived at as above indicated, of the old facilities and the new were then combined and from this total he subtracted the general expenses actually incurred in operating these facilities during June, 1950 and also state and federal income taxes, computed at a combined rate of 43.68%. This computation showed a net profit at a monthly rate of $242,493 which was annualized (on an 11½ months' basis) and capitalized at a rate of 20%, thus indicating a minimum value for the facilities of $13,943,350.

The possible maximum value for the facilities, which was stated at $15,443,350, was computed by assuming that Newport might install an additional electric furnace whose

production would be used in the strip mill, and then applying to the resulting increase in strip mill production the figures as to sales price and costs previously used.

(5) THE PIPE MILL. The witness also stated minimum and maximum values for the pipe mill. His minimum suggested valuation was $491,763, an amount equal to that actually expended by Newport on the mill by August 31, 1951, at which time it was still under construction. His maximum valuation was $3,058,130, based on a capitalization of its expected profits.

Defendant's expert, having testified to the above "values" for the Newport's component units, then added these figures together and gave as his opinion that the corporation had a minimum value of $20,245,222 and a maximum value of $24,311,589. On the basis of these figures, he then stated as his opinion that the 37% control block sold to Wilport had a value of between $7,500,000 and $9,000,000, or in terms of individual shares between $18.80 and $22.55.

The plaintiffs attack this valuation claiming that the method used was unsound and in any event not properly applied to the facts of this case.

As to the method of valuation, it is generally agreed that the primary determinant of the value of a going corporate business or of its outstanding stock should be the corporate earnings. *Campbell* v. *American Fabrics Co.* (CCA 2, 1948) 168 F. 2d 959; *Robertson* v. *Routzahn, supra.* However, any estimate of the amount of the corporation's earnings and the relation between earnings and value necessarily is dependent on a number of factors determinable only by the exercise of judgment faculties. At least where the value of small lots is at issue, courts frequently equate value with quoted market price, providing the stock is

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actively traded. *Groff* v. *Munford* (CCA 2, 1945) 150 F. 2d 825. This is partly because it is recognized that so far as the small investor is concerned, the "value" of a stock may depend as much on the available quoted price on a stock exchange as on a value determined by a capitalization of earnings. And plaintiffs contend that this method should be used here.

This position, I rule, is not tenable in the setting of this case. Where the block of stock is sufficiently large so that it cannot readily be sold within a few days through the normal channels of an exchange, considerations other than the quoted market price must necessarily be considered. On the one hand, it may be apparent that the stock probably could not be sold at anything approaching the quoted market price on a forced liquidation. *Groff* v. *Munford, supra.* On the other hand, and especially where the block of stock is relatively large enough to carry working control, it may well have a value in excess of the quoted price for small lots. And so it is that in the situation here the value determined primarily from earnings is a more reliable basis of valuation than evidence of small-lot sales or quotations. This is especially so since, as the plaintiffs themselves assert, the corporation's future, as of August 31, 1950, appeared considerably brighter than its recent past. In particular the new steel facilities, which had been some two years in process of installation, were then just beginning to get into full production. The market situation for the steel facilities, in contrast to the previous year, was very good. Under the circumstances it seems to me inherently reasonable to believe that a valuation suitably reflecting the prospect of future earnings was more reliable than quoted market prices or, indeed, than actual prices for recent small-lot sales which necessarily fail to reflect future prospects dependent on factors not generally known to the market.

Nor can I sustain the plaintiff's attack on the value which defendants' expert placed on the Detroit realty and the Universal Cooler Division. The valuation of these properties seems to me to be in all respects sound and to be based on the best available evidence. *Manufacturers Paper Co.* v. *Commissioner,* (CCA 2, 1937) 89 F. 2d 684. Similarly, I think that a valuation of the pipe mill on the basis of its actual cost to Newport till August 31, 1950 is entirely reasonable,—if anything, on the conservative side. And the witness's method of estimating the profits for the new steel facilities by computing their probable normal monthly profits is essentially sound—as reliable as any method one could devise for that difficult problem.

However, I find insufficient basis in the record here to affirmatively establish his "maximum" values on the new steel facilities and the pipe mill. I also find some plausibility in the plaintiffs' criticism of the following factors in the valuation as made by defendants' expert: (a) the estimate of future normal earnings for Caswell-Runyan; (b) the estimate of future normal earnings for the old steel facilities; (c) the use of a 42% tax rate; and (d) the capitalization rate of 20%.

The only other evidence which would tend to support a finding of a value for the block even as high as $18.80 per share is that given by the representatives of the Manufacturers Appraisal Co., who testified that in their opinion the "sound value" of the steel facilities was $39,983,262. Their study, however, was made primarily to determine the insurable value: it was based not at all on a consideration of earnings or earning capacity, and I think it clear, both on the basis of the witnesses' own testimony and also from a comparison of their estimates with the other evidence concerning these facilities, that their conclusions are useful only as checks on the valuation made on other bases.

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The plaintiffs' criticisms as listed above are all directed to judgment decisions made by the defendants' expert as of August, 1950. Considering the full impact of the facts disclosed in the record here upon the considered conclusions, as of that date, of a highly informed and experienced mind, although left without complete conviction that the witness is precisely right I cannot find him wrong—wrong either as to the particulars which plaintiffs criticize or in his final valuation.

Although the testimony of the defendants' expert on value is thus seen not to be precisely definitive, it is by far the best informed and most convincing testimony on the subject in the record. It demonstrates convincingly that the stock sold was worth very much more than $4,000,000, contrary to plaintiffs' contention. It amply supports a finding that there was no such excess in the payments received by the defendants over the fair value of the stock which they sold as to put the defendants on notice of sinister intentions on the part of the purchasers. It furnishes support for my conviction, based also on other evidence, that Feldmann was sincere in his belief that the stock sold was actually worth what he received. Whether, standing alone, it proved that the stock sold had a fair value of at least $40*, it is not necessary to decide. For as to that the burden was on the plaintiffs to prove a lesser value for the stock. *Stanton* v. *Schenck, supra.* That burden they have failed to sustain. Their failure on that score is ground for dismissal.

The defendants' contention that the action should be dismissed for lack of a prior demand on the directors to bring suit, I overrule. Some of the plaintiffs here did make such demand and the directors did not accede thereto. Moreover, where an Indiana corporation is under the control of those

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*Typographical error in original for $20.

whose acts are the subject of the contemplated suit, a prior demand on its directors is not necessary. *Wayne Pike Co.* v. *Hammond,* 129 Ind. 368, 27 N. E. 487. See also *First Merchants National Bank & Trust Co.* v. *Murdock Realty Co.* (1942) 111 Ind. App. 226, 39 N. E. 2d 507. That was essentially the situation here.

The defendants take the position that in so far as Feldmann's acts as a director are here in issue, they were ratified at the annual meeting of stockholders held on February 19, 1951. At the meeting in question the shareholders there present, either in person or by proxy, voted unanimously both to ratify all acts of the officers and directors since the last annual meeting and also, more specifically, to ratify the action of the corporate directors in resigning and electing their successors on August 31, 1950. Of the 864,619 shares present at the meeting 464,692 shares, or considerably more than half, were represented by proxies solicited by the corporate management.

The defense of ratification cannot be sustained. Before a shareholder may be said to have ratified a director's acts he must have been apprised of all the material facts and their legal effect. *Durfee* v. *Durfee & Canning, Inc.* (1948) 323 Mass. 187, 80 N. E. 2d 522, 531; *Farwell* v. *Pyle-National Electric Headlight Co.* (1919) 289 Ill. 157, 124 N. E. 449. That was not the case here. The defendants quote portions of a letter dated September 14, 1950, a proxy statement of January 19, 1951 and the 1950 annual report, which documents are claimed to have given the absent shareholders a full recital of all the facts material to the present causes of action. However, these documents made no mention of the price paid for the defendants' stock, of the understandings as to the installation of the new board immediately upon the consummation of the sale, or of the various facts on which the plaintiffs base their claim

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of probable injury to the corporation. Assuming for purposes of testing this defense that a right of recovery has been established, it seems hardly reasonable to hold it to be barred by the vote of the shareholders, a majority of whom are not proved to have had any knowledge of the particular facts on which that right is based. *Cf. Schemmel* v. *Hill, supra,* 169 N. E. 678 at 685.

New Haven, Connecticut.

December 8, 1952.

FOOTNOTES

1. There is no evidence that an additional electric furnace could have been obtained by Newport as of August 31, 1950; no satisfactory evidence of what the cost would have been; no evidence that Newport had the money to buy one; no evidence either as to the amount of time that it would have taken to install such a facility; and not even any evidence that serious consideration was being given to its acquisition.

So far as the pipe mill is concerned, I find nothing in the record as to the cost of its completion. There is no evidence, either, as to when, as of August 31, 1950, the mill might first have been expected to reach the 4,000 tons per month production postulated by the witness: it went into actual production in April, 1951 but its maximum production per month through September 1951 was only 2,657.73 tons. The witness's conclusion as to the probable profits of the pipe mill were based entirely on the opinion of the witness Riefkin—and there is no evidence whatsoever as to the basis of Riefkin's opinion nor that Riefkin had had any prior experience with pipe mills. Under the circumstances, to the extent that the witness's opinion stemmed from his conclusions as to the probable future income of the pipe mill and an additional electric furnace, I find it to be without sufficient basis to be acceptable. *Cf. Dairymen's Milk Co. of Pittsburgh* v. *McCormick Co.*, (CCA 3, 1940) 114 F. 2d 736.

2. (a) In arriving at his opinion as to the value of the Caswell-Runyon Division, the witness first had to reach a conclusion as to the probable future annual earnings of the division before taxes. This he computed by annualizing the average monthly earnings, before taxes, of the division for the ten months preceding August 31, 1950. The total earnings for this ten-month period were $580,342.88. The total annual earnings before taxes for the corporation's fiscal years 1949 and 1948 are also in evidence. They were, respectively, $124,421.09 and $195,180.21. It was the witness's opinion that the probable future annual earnings would be $696,000 per year. If he had taken into account the actual earnings of 1949 and 1948, in addition to those for 1950, his estimate, on the same basis, would have been $318,000.

There is no evidence in the record that there were any appreciable changes of any sort in Caswell-Runyon's facilities or business, or in the industry in which it does business, at any time in the previous three years. It is engaged in the manufacture of cabinets for radio and television sets. On cross-examination the witness admitted that the radio and television business is highly volatile and I was not impressed by his attempts to explain his failure to give any weight whatsoever to the 1949 and 1948 earnings. He did not attempt to explain the

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basis for his opinion on redirect. The witness had not examined the Division's plant, and there is no evidence that he had given special consideration to the Division's competitive position.

It is true that the Division's actual earnings before taxes during the company's 1951 fiscal year were $694,100.04. Actual earnings may well constitute the best of all possible checks on an estimate of earnings. But I cannot admit that an estimate of value as of 1950 may properly reflect 1951 earnings which could not be reasonably foreseen in 1950.

(b) Old Steel Facilities Earnings. In arriving at his estimate of normal future earnings for the old steel facilities the witness annualized the actual earnings for June, 1950. He had available to him also the actual earnings for April, May and August, 1950, all of which were lower than June, but did not take these into account. There are no comparable figures available for the earlier months of 1950 or for 1949. However, it does appear that the steel division as a whole suffered losses during May-December, 1949 and February-March, 1950. During 1949 the operations of the new facilities never rose above a fairly low level and it is inherently reasonable to assume that the losses suffered by the division during that period were primarily due to the operations of the old facilities. Under the circumstances I feel that the witness's use of June, 1950 as the basis of his estimate for future earnings was over-optimistic. On cross-examination he could explain his choice of such a limited base only by reference to the general economic conditions of the time.

(c) Tax-Rate. In estimating Newport's future earnings, the witness applied a federal income tax rate of 42%. In actual fact, however, the corporation paid income taxes at a rate of approximately 67% during its 1951 fiscal year. (According to Defendants' Exhibit 54, the corporation paid taxes of approximately $4,120,000. on earnings of $6,161,643 during that period.) The Korean War started in June, 1950. In the light of experience during the previous war, I should think that as of August 31, 1950 corporate tax rates considerably higher than 42% might reasonably have been expected for the immediate future.

When questioned as to his use of a 42% tax rate, the witness stated that the possibility of future tax rises was immaterial, since if he had postulated a higher tax rate he would then have made a compensating adjustment in his rate of capitalization. Although he did not explain the reasoning in back of this, I suppose that it may be based on a belief that a wartime rise in taxes would be likely to be accompanied by a general increase in prosperity so that the corporation's

net income after taxes would remain unchanged. If that is his reasoning, however, it seems to me that it results in his counting the same factor twice, since his estimates of future income before taxes appear quite optimistic in and of themselves. If, on the other hand, it is the witness's belief that the value of a business is not responsive to a drop in its net income caused by a rise in income taxes, I find myself unable to follow him.

(d) THE CAPITALIZATION RATE OF 20%. In capitalizing the income of both Caswell-Runyon and the steel division the witness used a multiplier of five. I find no basis in the record for questioning his judgment in this as to Caswell-Runyon. The situation as to the steel division is somewhat different.

It seems possible, if not probable, that Newport may be hard put to make a profit from its old facilities in any sort of economic environment other than the boom conditions which have prevailed during much of the last ten years. The competitive position of the new facilities is a matter of greater uncertainty: it is unlikely that Newport will ever be able to produce at as low a cost as its principal competitors but this competitive disadvantage may perhaps be balanced out by freight advantages. At any rate, there is scant ground for inference of profits from the steel division under any conditions other than those of an outright boom. The defendants' witness was of the opinion that as of August 31, 1950 the then current boom conditions might reasonably have been expected to continue for at least two or three years. As to that, I agree. However, in my judgment estimates as to the further future savor of the speculative.

It was the witness's statement that he had checked his multiplier by comparing it to the ratio actually existing between the current earnings and quoted prices of other stated steel companies. I am not satisfied, however, that the companies selected were fairly comparable, nor does it appear to me that the comparison supports the witness's opinion.

Obviously the selection of a proper rate of capitalization requires an exercise of a broad judgment. In writing the foregoing I am acutely conscious of the fact that one having the qualifications of this witness, given the requisite objectivity, is better qualified than I to make the selection. But even though I recognize the limitations of my own faculties for passing judgment on such a point I cannot accept the conclusions of another which seem to me unsupported by adequate reasoning. I hold, therefore, that in the particulars above specified not that the conclusion is wrong but only that in its full sweep it is not fully proved by the testimony of this witness.

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United States District Court

DISTRICT OF CONNECTICUT

JANE PERLMAN, *et al*, *Plaintiffs*, and HARRY MERNOFF, *Plaintiff-Intervenor* v. C. RUSSELL FELDMANN, *et al*	Civil Action No. 3086

FINDINGS OF FACT

I.

1. The plaintiff Jane Perlman and the plaintiff-intervenor Harry Mernoff are citizens of the United States and of the State of New York. The other plaintiffs are all citizens of the United States and of the State of Illinois. The plaintiffs each own shares of the common stock of Newport Steel Corporation which they acquired prior to August 31, 1950.

2. The defendant Newport is a corporation duly organized and existing under the laws of the State of Indiana, and thus a citizen of that state. The other defendants are all citizens of the United States and of the State of Connecticut and were such at and prior to the commencement of this action.

3. The amount in controversy exceeds $3,000, exclusive of interest and costs.

4. This action is not brought collusively to confer on the court jurisdiction it would not otherwise have.

5. The plaintiffs bring this action derivatively on behalf of Newport.

6. As of August 31, 1950 Newport had issued 1,221,870.2 shares of its common stock of the par value of $1 per share. Of these, 100,000 shares were owned by an almost-wholly-owned subsidiary of Newport, the R Company, and 43,378 shares were treasury stock. The balance of 1,078,492.2 shares were outstanding in the hands of the stockholders of Newport.

7. On August 31, 1950 the following persons or corporations owned the following number of shares of the common stock of Newport:

C. Russell Feldmann	0
Charlotte M. Feldmann	2,000
Strong, Carlisle & Hammond Co.	261,000
Henney Motor Co., Inc.	50,000
Carolyn F. Otto	7,300
Barbara Jane Feldmann	7,800
Phyllis F. McKee	7,300
John F. Otto	2,200
Joseph V. McKee, Jr.	2,525
Norman S. Feldmann	1,000
Raymond D. Feldmann	1,050
John C. Vega	600
Josephine V. Vega	600
	343,375

Strong, Carlisle & Hammond Co. is a corporation approximately 85% of the stock of which was owned by C. Russell

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Feldmann (hereinafter called "Feldmann") and members of his famiiy. Henney Motor Co., Inc. is a corporation the stock of which was owned 60% by Feldmann, and 10% each by his wife, Charlotte M. Feldmann, and by his three daughters. John F. Otto and the defendant Joseph V. McKee, Jr. are Feldmann's sons-in-law. Defendants Carolyn Otto, Phyllis McKee and Barbara Jane Feldmann are Feldmann's daughters. Norman S. Feldmann and Raymond D. Feldmann are Feldmann's brothers. John C. Vega and Josephine V. Vega are Feldmann's brother-in-law and sister-in-law, respectively.

8. The remaining 735,117 shares of Newport stock were owned by several thousand shareholders. Newport stock was traded over-the-counter in New York. Although it is impossible to determine the actual volume of trading in the stock, it apparently enjoyed a broad, fair and active market.

9. The 343,375 shares owned by Feldmann, his family, the Strong, Carlisle & Hammond Co. and the Henney Motor Co. amounted to approximately 33% of the outstanding stock of Newport. If voted as a unit, under the conditions existing as of August 31, 1950, this amount of stock would have given the holder working control of Newport.

10. Since December, 1940 and until August 31, 1950 Feldmann was the president of Newport. In August, 1950 he was also the chairman of its board of directors. His salary was $75,000 a year. The other four members of Newport's board of directors in August, 1950 were the defendant Joseph V. McKee, Jr., Feldmann's son-in-law; Frank L. Taylor; A. F. Lorenzen; and Daniel M. Sheaffer.

II.

NEWPORT'S FACILITIES AND COMPETITIVE POSITION

11. Prior to August 8, 1946, Newport, then known as International Detrola Corporation, was in the business of manufacturing radios and phonographs, aircraft components, refrigerator units, radio cabinets and radio speakers.

12. In late 1949 Newport disposed of its subsidiaries the Rohr Aircraft Corp., the Universal Cooler Co. of Canada, Ltd. and the Aircraft Tool Division. These subsidiaries had accounted for substantial portions of the company's sales and profits during 1948 and 1949.

13. In August, 1950, the principal business of Newport was the production of steel ingots and the manufacturing of hot rolled steel and sheet steel. Through its Caswell-Runyan Division Newport manufactured cabinets for radio and television sets; through its Universal Cooler Division it manufactured refrigerator compressors. It also had a blast furnace for the production of pig iron, located at Martins Ferry, Ohio. It also owned real estate in Detroit, Michigan.

14. The Caswell-Runyan (woodworking) Division as of August, 1950 consisted of a plant at Huntington, Indiana, which had about 500,000 square feet of floor space, many acres of land, and practically all new equipment, and a plant at Goshen, Indiana, consisting of 125,000 square feet of floor space.

15. Prior to August 31, 1950 Newport had planned to sell its Universal Cooler Division, and had made serious attempts to sell it. It was actually sold on October 31, 1950.

16. Prior to August, 1950 Newport's property in Detroit had been unoccupied for two years. During August,

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1950 Feldmann negotiated a lease of the property to the Government, at an annual rental of $165,000. The Government went into possession under the lease on August 14, 1950. The term of the lease was ten years and was to be extended from year to year for a period of five years unless terminated by the Government. The lease was renewed by the Government for another year on August 30, 1951. Under the lease, the Government had an option to buy the property from Newport for the price of $1,500,000, minus $191,000 of prepaid restoration charges.

17. Newport first entered the steel business in 1946. It then acquired for approximately $1,665,000 the assets of the Andrews Steel Co., located at Newport, Ky., directly across the Ohio River from Cincinnati, and at Wilder, Ky., about one mile south of Newport. The facilities acquired from Andrews consisted of about 200 acres of land, about 1,250,000 square feet of buildings with cranes and auxiliary equipment, together with seven open hearth furnaces, a blooming and bar mill, a sheet mill and facilities for fabricating culvert pipe, eaves troughs, down spouts, garage doors and roofing, and equipment for making galvanized, galvannealed and terne sheets. These facilities were and are used by Newport as part of one continuous operation: the open hearth furnaces make steel ingots, which are rolled into bar stock in the blooming and bar mill which in turn is rolled into sheets in the sheet mill. The normal product of the sheet mill is hot rolled, low carbon steel sheets. These sheets can be sold as such; or further processed by Newport into galvanized, galvannealed and long terne sheets; or fabricated by it into finished end products such as culvert pipes, eaves troughs, etc. The mill also produces sheets of silicon steel, a specialty steel used in electrical equipment, as well as an alloy steel which is used by aircraft manufacturers in building air frames. These facilities acquired

from Andrews are known collectively as the "old facilities." They have been in operation ever since their purchase.

18. On March 31, 1947, Newport acquired a blast furnace located at Martin's Ferry, Ohio, at a cost of $175,000. Newport then rehabilitated the blast furnace at a cost of $800,000 and it was put into operation in June, 1947. It was taken out of operation in June, 1949, and put back into operation again in June, 1951.

19. The blast furnace has a rated capacity of 12,000 tons of pig iron per month. Its sole usefulness to Newport lies in the fact that it is capable of supplying 100% of the pig iron requirements of Newport's seven open hearth furnaces. In periods of shortage of pig iron, Newport's open hearth furnaces mights not be able to operate without pig iron from the blast furnace. At any other time it would not be economically sound for Newport to operate the furnace. It is a marginal operation.

20. The open hearth furnaces have a rated capacity of about 34,400 tons of ingots per month and produce an average of 24,000 tons per month. The sheet mill has a rated capacity of 15,000 tons per month, but has exceeded that capacity. The average monthly production of the sheet mill was 11,906 tons in 1949 and 11,834 tons in 1950. The production of the sheet mill in the following months was:

1950	Tons
January	12,859
February	8,750
March	13,080
April	11,815
May	13,000
June	11,189
July	5,980
August	12,704

(Defendant's Ex. 32)

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21. The "old facilities" are capable only of high cost operation.

22. With respect to Newport's "old facilities": Newport's mill price for hot rolled sheets, 18 gauge and heavier, was, in August, 1950, $11-$27 per ton higher than the prices charged by certain other steel companies. In August, 1950, the prices charged by Newport for galvanized steel was $13 to $20 per ton higher than those charged by certain other steel producers. Newport's prices in August, 1950 for electrical, motor, dynamo and transformer (silicon) steel were the same as those charged by other producers.

23. It is unlikely that Newport would be able to sell hot-rolled, low-carbon steel sheets produced by its "old facilities" at a profit if the index of steel production fell to the level of mid-1949 (81%). However, it would probably be competitive with any other mill in the fields of alloy and silicon steel. No other mill in the Cincinnati area produces galvanized steel; the market for galvanized steel is local and Newport concentrates on the area within 100 miles of Cincinnati and to the south. Within that area Newport has a freight advantage which might permit it to sell some or all of its galvanized steel at a profit, even if the index of steel production fell to the level of mid-1949. In August, 1950 Newport's profits from its "old facilities" were accounted for as follows: app. 33.8% by sales of hot-rolled, low-carbon sheets; app. 14.6% by sales of coated sheets (galvanized, etc.); app. 21.5% by sales of alloy and silicon steel; app. 25.5% by sales of the fabricating departments, which make doors, etc.; and app. 3.2% by other items. Newport's management believes that if a drop in demand for steel occurred, the profits of its "old facilities" could be maintained by shifting its production and sales away

from low-carbon sheets. Yet it appears that in 1949, when Newport's sales of steel were cut in half as a result of a drop in demand and the company suffered a loss for some months, no such shift was made. On the basis of the past history of these facilities, it is questionable whether they could be operated profitably if the index for steel production fell to 80% or lower.

24. Between 1948 and 1950, Newport acquired additional steel facilities, referred to as the "new facilities", consisting of a melt shop containing one electric furnace, acquired from the War Assets Administration in the spring of 1948; two additional electric furnaces installed in the melt shop which were put in operation in March and May, 1950; an additional large building acquired from the War Assets Administration in the spring of 1948; and a reversing hot strip mill for the production of hot rolled steel strip, installed in said building in late 1948 and early 1949. These facilities, together with the pipe mill, referred to *infra*, were intended to be and are operated as a unit. They are adjacent to Newport's old facilities in Wilder, Ky. The facilities acquired from the War Assets Administration were obtained at a price of $1,350,000. Feldmann had been informed that these facilities had cost the Government $7,000,000 to build during the war. The final cost to Newport of its "new facilities", as they existed when completed, was $10,798,000.

25. Although Newport's "new facilities" were originally scheduled for completion in August, 1948, the actual completion was long delayed and they had never achieved their expected normal production by August 31, 1950.

26. The electric furnaces have a theoretical rated capacity of 24,300 tons of ingots per month; they were ex-

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pected to have a normal monthly production of 22,000 tons per month. The last of the three furnaces was placed in production in May, 1950. Actual production during the four months starting in May was as follows:

Month	Tons of Ingots
May, 1950	14,963
June, 1950	15,984
July, 1950	15,072
Aug., 1950	16,506

27. The theoretical rated capacity of the strip mill was 25,000 tons per month although it was capable of producing somewhat more. If all the normal 22,000 per month output of the electric furnaces were put into the strip mill, 18,700 tons of sheet and coil would be produced, as the yield of the strip mill is 85%. Additional strip mill production might perhaps be obtained by converting ingots bought from other mills or furnished by customers. The strip mill first went into production in May, 1949 but until December, 1949 it never produced more than 5,500 tons per month. Its actual production from December on was as follows:

Month	Tons of Strip & Coils
December, 1949	6,611
January, 1950	5,329
February, "	7,108
March, "	11,129
April, "	10,475
May, "	9,140
June, "	12,827
July, "	7,967
August, "	16,314

During these months none of the strip mill's production was obtained from ingots furnished by customers or purchased from other mills.

28. As of August, 1950 it was reasonable to assume that the new facilities would soon attain their expected normal monthly production.

29. In contrast to open hearth furnaces which use pig iron as part of their "charge", the raw material used in electric furnaces is scrap. Steel produced by electric furnaces is of better quality than steel produced by open hearth furnaces.

30. At the time that the "new facilities" were first contemplated, i.e., app. January, 1948, it was estimated that Newport's scrap costs per ton would be at least five dollars higher than the "Bix Six". As of August, 1950, however, Newport was paying the same amount for scrap as the "Big Six".

31. Newport's reversing strip mill is a modern automatic mill, one of the first of its type, although similar mills have since been built by other steel companies. It compares favorably with the new strip mill of Crucible Steel Co., which is a competitive mill.

32. At the time that the "new facilities" were first contemplated it was estimated that Newport's costs in operating them, aside from raw material costs, would be about five dollars per ton higher than the "Big Six" when the facilities were operating at full normal production. As of August, 1950 Newport's actual conversion costs were slightly higher than those of the "Big Six". Unit costs tend to decrease as a steel mill approaches capacity production.

33. The big steel mills, like those of the "Big Six", are the principal competitors of Newport's new steel facilities. In August, 1950 Newport charged the same base price for its hot rolled sheets produced by the new facilities as was charged by the lowest priced steel producers for the same

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product and Newport's prices for extras were likewise the same. No other steel producer sold the same product at a lower price and some charged higher prices. However, most of Newport's August production was committed to General Motors Corp. In December, 1949, Newport gave General Motors a continuing option effective until June, 1953 to purchase 10,000 tons of steel a month from the new facilities at "Big Six" prices. The option was still in effect in August, 1950.

34. The market for hot rolled steel in coil and cut lengths in the area within 150 miles of Cincinnati is five to seven times Newport's capacity production of that product. Within that area, as against the "Big Six", Newport has the advantage of lower freight rates which, since steel prices are F. O. B. mill, might enable Newport, at a time when the index of steel production in the United States is 90-95%, to sell all the production of its new facilities, even if Newport's prices were $4 or $5 per ton higher than the "Big Six."

35. In March, 1950, Newport purchased a slightly used pipe mill from International Rolling Mills Products Corp. for $450,000. The pipe mill, which had not yet been placed in operation in August, 1950, was intended to use steel produced by the hot strip mill, and as of that date the cost of the pipe mill to Newport—and its book value—stood at $491,763.00.

36. At the time of purchase the future earnings of the pipe mill were estimated by a firm of management engineers to be $100,000 to $150,000 a month. It had a rated capacity of 3,000 tons per month, but Newport's general manager of its steel division, Mr. Riefkin, had estimated that it "should" produce 4,000 tons per month. In order to produce 4,000 tons of pipe, Newport would have to supply the pipe mill

with 4,500 to 4,700 tons of coil from its strip mill. It was estimated that Newport would realize a profit of $30 per ton on sales of pipe at competitive prices. The mill did not actually go into production till March, 1951.

III.

"FELDMANN PLAN" FINANCING

37. In the 10-year period prior to August, 1950, the steel industry in the United States was, with the exception of a short period in 1949, in a boom condition. There was a scarcity of steel in 1946, 1947 and 1948 as well as during the summer of 1950; the market for steel was tight throughout the year 1950 and continues to be tight. In July and August, 1950, the demand for the steel produced by Newport far exceeded its then capacity.

38. Newport raised the money to purchase its "old facilities" from the Andrews Steel Co. by borrowing from banks. Shortly after acquiring these facilities Newport entered into contracts with seven of its customers pursuant to which Newport agreed to sell and the customers to purchase certain quantities of steel over a period of 36 months at a total contract price of $35,100,000 (except that Borg-Warner agreed to take its share of the steel over an 18-month period). The amount of steel committed represented 50% of Newport's expected production. In consideration of this commitment, the customers advanced an aggregate of $3,510,000 to Newport. These advances were free of interest and were to be amortized against 10% of the price of the steel to be delivered. Part of the $3,510,000 thus obtained was used to pay off $2,000,000 of the bank loans and the rest was used for working capital.

39. In January, 1948 Newport, under the management of Feldmann, received advances of $5,000,000 from three

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customers, Packard Motor Car Co., Borg-Warner Corp. and Houdaille-Hershey, to be used in the purchase and installation of its "new facilities." The advances were made under the terms of contracts which provided that Newport would ship and the customers would purchase specified quantities of steel from the "new facilities", half during an 18-month period beginning August 1, 1948 and the balance during the following eighteen months. The steel was to be paid for at the average base price quoted by the "Big Six" steel companies and, in addition, the purchasers were to pay a premium of $20 per ton of steel shipped during the first 18 months.

The contracts provided that Newport was to be obligated to repay the advances of $5,000,000 at the end of the first 18-month period and until then they were not to bear interest. The contracts further provided that the $20 per ton premium above "Big Six" prices on steel delivered during the first 18 months was to be credited against the amount of the advances, and the contract arrangements were such that, if Newport delivered the full amount called for during that period, the $5,000,000 in advances would be considered completely repaid. If Newport's steel shipments should be interrupted by causes beyond its control for any period, the initial 18-month period for the repayment of the advances was to be correspondingly extended. However, with certain limitations, if Newport did not meet its contract commitments as to delivery schedules and quality of steel, the customers could refuse to accept any further steel and thus deprive Newport of its opportunity to have the advances cancelled through shipments of steel. There was no provision for an acceleration of the due date of the advances, which were made subject to Newport's outstanding debentures. Furthermore, Newport, in case of an inability to make the required shipments from its "new facilities", had

the right to substitute steel produced by the "old facilities", at least for a period of six months.

40. On December 6, 1948 Newport entered into a contract with General Motors Corp. under which General Motors agreed to and did advance to Newport $5,000,000 on terms similar to the Borg-Warner etc. contracts.

41. It is customary for costs to be high during the first year or year and a half of operation of a new type mill. In addition, in planning Newport's new facilities, it was estimated that Newport's costs would probably always be higher than those of the "Big Six".

42. Due to difficulties in getting the strip mill into production, Newport was unable to make the deliveries called for in the loan contracts, and by early 1949 was hopelessly behind in deliveries. Out of the $10,000,000 borrowed, approximately $1,200,000 was earned by the $20 per ton fees on steel delivered, leaving a balance of $8,799,076.87 owing. Since Newport was in default under the contracts, the lenders were demanding their money. Feldmann negotiated a settlement of this indebtedness by payment of $4,399,538.50, together with an option to General Motors for 10,000 tons of steel per month until June, 1953. Newport raised the money to make this payment by the sale of Universal Cooler of Canada, Rohr Aircraft Corporation, and its Aircraft Tool Division.

43. In March, 1950, as part of the same agreement by which it purchased its pipe mill for $450,000 from International Rolling Mills Corp., Newport granted International an option to buy from it, at its mill prices, substantial amounts of steel for a specified period of time. Under these options International thereafter purchased an aggregate of 28,833 tons of steel from Newport at its mill prices.

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44. The method of financing the acquisition and operation of steel facilities by obtaining advances from steel customers—the advances being given in consideration for steel commitments undertaken by the steel producer—was originated by Feldmann and to some extent has been adopted by other steel companies. It is known in the steel industry as the "Feldmann Plan."

IV.

THE FOLLANSBEE MERGER NEGOTIATIONS

45. The end product of Newport's new steel facilities is known as hot rolled sheet or hot rolled coil. While this is a marketable commodity, it is often further processed by a so-called "cold rolling" process. A cold rolled sheet has a finer finish and a lighter gauge than a hot rolled sheet and is used principally for more difficult work. As of August, 1950, Newport had no cold rolling facilities.

46. In the summer of 1950, if such facilities could have been obtained at a price and under terms which were advantageous to Newport, it might have been desirable for Newport, and Feldmann so understood, to install cold rolling facilities in order to give Newport a more fully integrated operation. The cost of installing cold rolling facilities would have been at least five to ten million dollars, which Newport did not have.

47. Newport commenced negotiations with Follansbee Steel Corporation in May, 1950, looking toward a merger of the two companies. Newport was interested in acquiring cold rolling facilities with known costs, and without the delays and risks attendant upon building a new mill, if that could be on advantageous terms. Follansbee had such facilities, but would not consider an exchange basis less favorable to it than 1¾ shares of Newport for one share

of Follansbee. Feldmann stated that a merger on the basis of 1¾ to one would not be in the best interests of Newport and all its stockholders, and took the position that a fair and proper exchange ratio should be 1½ to one; Ruttenberg, the broker promoting the deal, agreed that Feldmann's position was a reasonable one, although he tried to influence Feldmann to consider the Follansbee suggestion by pointing out that Feldmann would personally profit substantially thereby. Follansbee never made a firm offer of merger on any basis and Follansbee's Board of Directors decided on July 11, 1950 against a merger on a basis of 1½ to 1. On July 12, 1950, Follansbee and Newport mutually agreed to suspend the merger negotiations until October 31, 1950 since they were unable to agree on terms. In addition to the unfavorable merger terms suggested by Follansbee, Newport had serious operational objections to the merger, based upon the distance of the Follansbee mill from Newport and the incompatibility of its equipment. On July 28, 1950, Newport's Board of Directors unanimously approved the suspension of the negotiations for an indefinite period.

48. The common stock of Follansbee was listed on the New York Stock Exchange. During May, June and July, 1950, while the merger negotiations between Follansbee and Newport were under way, the market price of Follansbee common stock was approximately $16 per share.

49. With the outbreak of the Korean war, there was a possibility that the Government might advance the money to Newport to put in cold rolling facilities on its own property and give Newport priorities to expedite the construction, as was done in World War II.

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V.

THE SALE OF STOCK TO WILPORT

50. During the late spring and early summer of 1950, when as above stated the steel market was tight, Feldmann began receiving numerous inquiries from persons interested in a possible purchase of his stock interest in Newport. One such inquiry, in June or July, 1950, was from a Mr. Barney Hokin, the president of International Rolling Mill Products Co., who asked if Feldmann would take $20 a share for his stock. Another such inquiry was from Mr. Ruttenberg, a broker, who on June 6, 1950, inquired as to whether Feldmann would accept $10 a share.

51. On August 8, 1950, Sidney Coe of Irving Trust Company called Feldmann on behalf of William J. Mericka and asked Feldmann if he would meet with Mericka, whom he described as a very substantial person, who had previously been substantially interested in Empire Steel Company. Mericka is president of William J. Mericka & Co., investment securities dealers in Cleveland, and chairman of the Executive Committee of the Bingham-Herbrand Corporation, which makes stampings and forgings. Bingham-Herbrand is an "end user" of steel, i.e., a company requiring steel for the manufacture of its products. Feldmann had not previously met Mericka but had heard the name of Mericka & Co. mentioned favorably many times.

52. On August 9, Feldmann and William Alfs, a Vice-President of Newport and Feldmann's personal counsel, met with Mericka and Frank Cobourn in Detroit. Cobourn is a partner in a Toledo law firm and counsel for A. P. Parts Corp., an end user of steel. Mericka told Feldmann that he represented a group of end users of steel which might be interested in acquiring all of Feldmann's holdings in

Newport Steel. The group then consisted of Gibson Refrigerator Co., Mitchell Manufacturing Co., Prentiss-Wabers Co., A. P. Parts and Bingham-Herbrand. Feldmann indicated that he might consider selling to such a group and said that he would not consider less than $22 per share.

53. The dominant motive of the purchasing group in seeking to purchase Feldmann's controlling stock interest in Newport was to obtain a continuing source of steel supply. Feldmann knew during the negotiations that such was their motive.

54. On August 9, 1950 the price of Newport's common stock was quoted in the over-the-counter market at 8¼ bid 9 asked. Feldmann stated, however, that he thought the true value of the stock was much higher than that, and even higher than its book value of $17.03, because there were intrinsic values not reflected by the books and because of the improving future outlook for Newport.

55. Feldmann talked again with representatives of the purchasing group on August 10, August 14, and August 24, 1950.

56. During the course of these talks the parties discussed in some detail Newport's business, including contractual agreements, earnings, the values of the divisions, and personnel. Feldmann recommended that, if he sold his stock, every officer should be kept in his present position since they were a fine operating organization. Feldmann stated that in his opinion the steel division was undervalued on the books to the extent of $6,000,000 or $7,000,000 and the Detroit property by at least $1,000,000. He stated also that Caswell-Runyan was undervalued, since the fixed assets were on the books at only $600,000.

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57. Among the subjects covered in the negotiations were the following. What could Newport manufacture that would be helpful to an end-product user such as the members of the purchasing group? What was the type of steel produced by Newport? What were the existing contractual commitments of Newport for the sale of steel? What steel would be available to the purchasing group when and if the existing commitments expired? Feldmann furnished information on these points in response to questions by the representatives of the purchasing group.

58. During the course of negotiations Feldmann stated that if he were to sell his stock, it would be to a group of the sort represented by Mericka and Cobourn, who, he stated, because they were end-users of steel, were likely to be customers for Newport's steel when steel demand was low. It was Feldmann's sincere belief that stock-ownership in end-users would lend stability to Newport.

59. Feldmann made arrangements for Mericka to visit Newport and inspect the plant. Mericka did so on August 16 and returned again on August 22 with other members of the purchasing group, as well as Mr. James H. Hill, a top flight operating man in the steel industry. Mericka, Hill and the rest were all much impressed by Newport's steel facilities.

60. During the negotiations, representatives of the accounting firm of Seidman & Seidman examined Newport's financial records on behalf of the purchasers. However, they did not audit the books.

61. During the negotiations, Feldmann instructed Newport's general counsel William A. Alfs,, Newport's chief financial officer Harry E. Hamilton, and the manager of Newport's steel division Carl M. Riefkin, to furnish to the

purchasing group any facts or figures they might request. All information requested by the purchasing group was furnished, including information respecting existing commitments, expiring dates and new production. At Feldmann's request, Riefkin prepared an estimate of Newport's uncommitted production for the balance of the year 1950, which was delivered to the purchasing group.

62. During the negotiations the representatives of the purchasing group stated that they intended to go forward with the policy, previously decided on by Feldman and his associates, of causing Newport to sell off its divisions not engaged in the manufacture of steel.

63. On August 24 Feldmann went to Chicago for a meeting with Cobourn and Mericka. He first went to two banks in order to inquire about Frank Gibson, Charles Gibson and Gibson Refrigerator Co. on whom he received very favorable reports from both banks. Feldmann then went to the Ambassador East Hotel where Alfs, Cobourn and Mericka were waiting. Mericka said that he and Hill had both been very impressed by Newport. Mericka said also that in order to pay for the minimum number of shares that Feldmann was willing to sell, it would be necessary to expand the purchasing group. Feldmann asked who would be in the final group and Mericka stated that the group had not yet been finalized, but Maytag Washing Machine Co. and Hudson Motor Car Co. would undoubtedly be members, and that the group would be composed only of responsible companies who were end-users of steel. Mericka then offered $18 per share for approximately 400,000 shares on the basis of a short term option for half the stock and a 30 to 60 day option for the other half. Feldmann refused the offer. Cobourn then reported back to other members of the purchasing group while Mericka remained with Feldman. Mericka,

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after talking with Cobourn on the telephone, offered Feldmann $20 per share. Feldmann accepted this offer.

64. Prior to the drawing up of an option agreement, the parties also reached an informal understanding as to the following matters: (a) if the purchasing group were to exercise only half of the option, it would then be entitled to one representative on the Newport Board of Directors; and (b) if the option were exercised in its entirety, Feldmann would then resign as an officer and director of the corporation, procure the resignation of his fellow directors and assist in the election as directors of the nominees of the purchasing group.

The option was to be assignable. Feldmann did not believe it necessary to restrict Mericka in any way as to the identity of the assignee since he considered Mericka a responsible individual who would adhere to his stated intention of assigning the option to the purchasing group previously identified. Mericka told Feldmann that three of the purchasing group's designees for the Newport Board of Directors would probably be Frank S. Gibson, Jr. (Vice President of Gibson Refrigerator Co.), Mericka and Cobourn, and that Gibson would probably succeed Feldmann as President and Chairman of the Board.

65. Alfs then wrote out the following option in longhand, which Feldmann signed:

August 24, 1950

"William Mericka:

For and in consideration of $100, receipt of which is acknowledged, I agree to sell to you 200,000 shares of Newport Steel Corporation for $4,000,000—at any time on or before August 31, 1950.

If you exercise this option on or before Sept. 1, 1950, on the terms above set forth, I will give you at that time an option to buy an additional number of shares of Newport Steel Corporation, not less than 175,000 shares nor more than 200,000 shares at $20. per share, until 12:00 noon E.S.T. Nov. 1, 1950.

If you exercise the option to buy the shares (minimum 175,000, maximum 200,000) on or before Nov. 1, 1950, I will deliver to you, at the time you exercise the option, the resignation of all of the members of the Board of Directors of Newport Steel Corpn.

(Signed) C. Russell Feldmann"

66. After August 24, 1950, and before August 31, 1950, Feldmann made private inquiry with respect to Cobourn, and was informed that Cobourn was a capable lawyer, of highest reputation. In that period, he met Bernard Mitchell, President of Mitchell Manufacturing Company who had previously been associated with the Gibson Refrigerator Company in Apollo Steel Company.

67. On August 29, 1950, the purchasing group organized a Delaware corporation known as Wilport Company (hereinafter referred to as "Wilport"), for the purpose of purchasing and holding the Newport stock covered by the option agreement. Mericka assigned the option to Wilport. Between August 24 and August 30, 1950, the purchasing group was expanded to comprise sixteen members, all of them end users of steel. The group members paid an aggregate of $8,200,000 to Wilport to enable it to exercise the option, and received in return stocks and notes of Wilport ratably according to their contributions.

68. On or before August 31, 1950, the Wilport stockholders informally agreed among each other that they were to have the privilege of buying steel from Newport in pro-

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portion to their respective investments in Wilport. They intended, if possible, to buy about 15,000 to 20,000 tons of steel per month from Newport.

69. Mericka told Feldmann that he should be in Chicago on August 31, and should have his stock available, although there was no guarantee that the entire option would be exercised. On August 29 or 30 Alfs, who had been in frequent touch with Cobourn, told Feldmann that he and Cobourn had drafted a contract containing, among other things, a covenant which the purchasers insisted on, whereby Feldmann would agree not to compete in any business Newport was engaged in for five years. This provision was not envisioned by the option agreement, and Feldmann would not agree to inclusion of such a provision at first, but finally agreed to accept it as later modified.

70. On August 31, 1950 Feldmann went to Chicago, Ill. and at that time Wilport exercised the option which Feldmann had given to Mericka on August 24 and which Mericka had thereafter assigned to Wilport. Feldmann delivered to the Continental Illinois Bank 398,927 shares of Newport stock and Continental delivered to Feldmann, unconditionally, checks for $7,978,540 in payment of the stock at $20 per share and the sale was completed. These 398,927 shares (approximately 37% of Newport's stock) constituted a control block of Newport. At the time of the sale Feldmann executed the written agreement of sale previously drafted by Cobourn and Alfs. By the agreement, Feldmann warranted that Newport had given no steel commitments other than in the normal course of business, except certain commitments specially listed. The agreement contained no representation or warranty that the financial statements of Newport, which Feldmann had furnished to the purchasing group, were correct.

71. Among the 398,927 shares of Newport, which Feldmann sold and delivered to Wilport, were the 343,375 shares owned or controlled, directly and/or indirectly, by Feldmann and members of his family. The balance was made up by the shares of numerous friends and associates of Feldmann.

72. In addition to Feldmann himself and his family, all of Newport's directors participated in the stock sale to Wilport by selling the following numbers of shares at $20 per share:

J. V. McKee, Jr.	2,525 shares
D. M. Sheaffer	5,000 "
F. L. Taylor	2,000 "
A. F. Lorenzen	1,010 "

73. In the selling the 398,927 shares of Newport to Wilport, Feldmann acted for himself and as agent of the owners of said shares, including defendants Charlotte M. Feldmann, Joseph V. McKee, Jr., Phyllis McKee, Carolyn Otto and Barbara Jane Feldmann.

74. After the consummation of the sale Feldmann convened a special meeting of Newport's board of directors. Three of Feldmann's co-directors, namely, McKee, Lorenzen and Sheaffer (who resided, respectively, in Connecticut, in Miami, Fla., and in Philadelphia, Pa.) were present. Feldmann had with him the signed resignation of Newport's fifth director, Taylor. Immediately prior to the meeting Feldmann was for the first time informed of the identity of the full slate of directors proposed by Wilport, namely Frank Gibson, Mericka, Cobourn, Paxton and Mitchell. Feldmann knew that Paxton was a member of a well known, reputable, Chicago law firm and general counsel to Gibson Refrigerator Co.; Alfs had previously spoken favorably of him. After the meeting was convened the directors of New-

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port successively resigned and, as each vacancy arose, the Board elected successively as new directors Frank Gibson, Paxton, Cobourn, Mericka and Mitchell; Feldmann voted for each of the directors except Mitchell.

75. Each of the new directors of Newport was a director of Wilport.

76. At the aforesaid meeting of Newport's board of directors on August 31, 1950, Feldmann also resigned in his capacity of chairman of the board and president of Newport. Alfs resigned as vice-president and general manager of Newport and Hamilton resigned as secretary of Newport. Newport's new board of directors then elected the following: Gibson, chairman of the board of directors and president of Newport; Mericka, vice-president; Paxton, secretary and counsel; and Hamilton, assistant secretary. Some time after August 31, Mitchell was elected vice-president of Newport. Feldmann and Alfs were the only two officers of Newport who served prior to August 31, 1950 who are no longer officers of Newport.

77. At no time did Feldmann or any defendant intend or attempt to work any harm to Newport or to its other stockholders through joint or several action amongst themselves or in concert with the members of the Wilport group.

78. Neither Feldmann nor any other defendant, whether in fiduciary capacity or otherwise, failed to use all reasonable care in connection with the sale of their stock in preventing harm to Newport and other stockholders.

VI.

WILPORT'S NEED FOR IMMEDIATE CONTROL OF NEWPORT

79. As of August, 1950, all steel orders accepted by Newport, other than long-term contractual commitments, were expected to be filled in the normal course by December 31, 1950. The only long-term contractual steel commitment of Newport, scheduled to extend beyond December 31, 1950, was its contract with General Motors Corporation, dated December 12, 1949, under which General Motors had an option to buy up to 10,000 tons of steel per month until June 30, 1953.

80. As of August 24, 1950 Riefkin, the general manager of the steel division, estimated that Newport would have available, over and above the amounts already committed, 4,830 tons of strip and 6,900 tons of ingots from its November production and 6,000 tons of strip and 9,800 tons of ingots in December.

81. During July and August, 1950 it would have been possible for Newport to commit all of its open production to customers in the ordinary course of trade for a period extending into 1951 at the mill prices prevailing at the time of delivery. Considering the past history of Newport's business and the condition of the steel market as of then, it is not unreasonable to assume that Newport might have been able in July and August, 1950, to make long range contractual commitments for substantial portions of its expected production during the next year or two.

82. As of August, 1950 Newport did not normally accept orders more than ninety days in advance of delivery.

83. During the eight months preceding August 31, 1950, six members of the purchasing group (Grand Sheet

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Metal Products Co., Acklin Stamping Co., Prentiss-Wabers Products Co., Webster Chicago Corporation, A. P. Parts Corp. and Motorola Inc.) had been steel customers of Newport. In no one of these months had these firms been able to buy an aggregate of more than 500 tons of steel from Newport although all customers of Newport during that period had tried to buy larger amounts of steel.

84. It was important to the purchasers of Feldmann's stock, in order to make available to themselves as soon as possible the maximum amount of steel from Newport, to obtain the immediate resignation of the officers and directors of Newport; otherwise it would have been legally possible for the old management to make commitments to others. It was desirable for the purchasers to obtain the substitution of their own nominees as directors so that they could immediately determine Newport's sales policy, control commitments for Newport's steel and determine the prices and terms of sale without the expense and delay of holding a special stockholders' meeting to fill the vacancies on the board.

85. Feldmann made no effort to obtain for the other stockholders of Newport a price for their stock similar to that which he received and which he made available to certain of his personal friends, relatives, associates and to officers and directors of Newport, nor did he make any misrepresentations either to other stockholders or to others in connection with his sale.

VII.

THE EFFECT OF THE SALE ON NEWPORT

86. During the summer of 1950 and thereafter, to the knowledge of Feldmann various steel producing companies other than Newport received from end-users of steel large

advances of the "Feldmann Plan" type in return for agreements to sell steel to them. Thus Jones & Laughlin Steel Corp. borrowed $28,000,000 from General Motors Corp. in June of 1950; Republic Steel Co. borrowed $40,000,000 from General Motors Corp.; Pittsburgh Steel Corp. borrowed $[illegible]000 from Chrysler Corp. and $2,000,000 from Packard Motor Car Co.

87. Whether or not, in August, 1950, Newport's position was such that it could have entered into "Feldmann Plan" type transactions to procure funds and financing for the further expansion and integration of its steel facilities and whether such expansion would have been desirable for Newport, the evidence does not show.

88. During the summer of 1950, Feldmann made no effort to explore the possibility of obtaining from end-users of steel funds or advances of the "Feldmann Plan" type in return for an undertaking by Newport to sell its uncommitted excess production of steel.

89. Feldmann never inquired from Mericka or Cobourn or any other member of the purchasing group whether it would be possible to obtain from the purchasing group an advance to Newport of the "Feldman Plan" type in return for a commitment by Newport to sell steel to them.

90. In August, 1950, the state of the steel market was such that a loan to Newport on favorable terms would have constituted a cloak to conceal an unethical gray market transaction if conditioned on a commitment of output from existing facilities as distinguished from new facilities to be financed by the loan.

91. Since the Wilport group were end-users of steel who intended to divert some of Newport's steel production to themselves, Feldmann's sale of a control block of Newport

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stock to Wilport might have been expected to result in a management less willing to make a commitment of output of facilities existing as of August, 1950 in return for customer loans. The mere fact that Newport's new directors and officers might have interests as end-users would not constitute incentive to stifle desirable expansion financed by commitments *upon new facilities*.

92. None of the members of the Wilport group was located within 150 miles of Newport's plant; some were as far away as 750 miles.

93. Since the Wilport nominees took over the management of Newport on August 31, 1950, substantial improvements have been made in Newport's property and the corporation has enjoyed continued prosperity. Although the Wilport stockholders have purchased substantial quantities of steel from Newport, no sales were made at less than Newport's quoted mill prices. There is no evidence of any sort that Newport has suffered from mismanagement or inefficient management since August 31, 1950, or that it has suffered or is likely hereafter to suffer any harm whatever at the hands of its new management, or that its new management has in any way failed to do anything which should have been done for the good of the corporation.

VIII.

VALUE

94. Between August 28 and August 30, 1950, Feldmann purchased for his family members and for Mary Hayward (his secretary) and Nora E. Hertzfeld (daughter of Newport's counsel William A. Alfs) a total of 14,800 shares of Newport at prices ranging from $9.69 to $12 per share. Feldmann purchased most of these shares from three close

friends of his. Feldmann's said family members as well as Mary Hayward and Nora E. Hertzfeld promptly resold these 14,800 shares to Wilport at $20 per share, as part of the 398,927 block sold by Feldmann. Their total profit on these 14,800 shares was $132,070.

95. One or two days before August 31, 1950, Mericka, at Feldmann's request, bought 1,000 shares of Newport for the account of Riefkin, the manager of Newport's steel division, at approximately $11 per share. These shares were then sold for Riefkin's account by Feldmann to Wilport as part of the block delivered by him at $20 per share. Riefkin received a profit of slightly over $9,000 from this transaction, without any investment on his part.

96. On August 24, 1950 Newport stock was quoted on the over-the-counter market at 8½ bid, 9½ asked. On August 31, 1950 the quotations were 10 5/8 bid and 11 5/8 asked. Between August 28 and August 30, 1950 relatives, friends and associates of Feldmann purchased at least 3,000 shares of Newport stock in the market.

97. During the nine months preceding August 31, 1950, transactions involving substantial amounts of Newport stock included the following:

(a) In December, 1949, Newport sold the assets of its subsidiary, Rohr Aircraft Corporation, for $5,600,000. The buyer was a corporation organized by F. H. Rohr and J. E. Rheim, former directors of Newport, and their associates. The purchaser obtained and exercised an option to deliver 100,000 shares of Newport stock in lieu of $500,000 of the purchase price, i. e., at the rate of $5 per share. At that time, the book value of the shares of Newport was approximately $16.60 a

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share, only slightly less than their book value as of August 31, 1950, which was $17.03 a share.

(b) In December, 1949, Newport purchased from the manager of its Universal Cooler division 8,505 shares of Newport stock for a price of $50,000, amounting to $5.88 a share.

(c) On February 14, 1950, as of October 31, 1949, Newport sold the assets of its aircraft tool division in consideration of $500,000 cash and 10,000 shares of Newport stock which Newport took in at their then approximate market of $7.50 a share.

98. Between August 28 and August 30, 1950, Feldmann purchased, for members of his family and friends,

2,000 shares of Newport stock from A. H. Sarver at $10 a share;

3,000 shares of Newport stock from F. S. McNeal at $10 a share;

7,800 shares of Newport stock from F. L. Taylor at $12 a share.

Sarver, McNeal and Taylor were friends of Feldmann; Taylor was also a director of Newport. At their request Feldmann fixed the prices paid them for their shares as the fair prices thereof.

99. The book value of Newport stock on August 31, 1950 was $17.03 per share.

100. The book value of the plant, property and equipment of Newport's various divisions was, as of August 31, 1950:

Division	Net Book Value
Rolling Mill Division	
Newport, Kentucky	$ 723,931
Wilders, Ky.—Old Facilities	441,955
Wilders, Ky.—New Facilities	10,315,894
Pipe Mill	491,763
Martins Ferry, Ohio	819,186
	$12,792,729
Refrigeration Division	
Marion, Ohio (Universal Cooler).	$ 1,138,767
Radio Division	
Detroit, Michigan	367,630
Huntington, Indiana (Caswell-Runyan)	489,891
Goshen, Indiana (Caswell-Runyan)	190,642
	$ 1,048,163
	$14,979,659

These figures, it should be noted, are exclusive of inventories.

101. In 1951 the Manufacturers Appraisal Co. appraised Newport's steel facilities in order to determine their "cost of reproduction" and "sound value" as of May 31, 1951. In arriving at the "cost of reproduction" the company attempted to determine what it would cost to erect or purchase facilities or machines identical to those currently owned by Newport. Where identical machines were not then available the company took the price of the most nearly comparable machine of those then on the market. "Sound value" was determined in the case of each machine or facility by applying a percentage of depreciation. The percentage of depreciation was in almost all cases determined by a field appraiser employed by Manufacturers' Appraisal Co. who based his determination on what he believed to be the actual

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depreciation. It was the opinion of Manufacturers' Appraisal Co. that the reproduction cost and "sound value", respectively, of Newport's steel facilities as of May 31, 1951 were:

	Cost of Reproduction	"Sound Value"
Sheet Mill—Newport (Old Facilities)	$14,359,366	$ 8,576,510
Steel Plant—Wilder (Old Facilities)	21,454,195	12,429,604
Wilder Section (New Facilities)	18,861,024	15,686,344
Blast Furnace (Martin's Ferry)	4,833,132	3,290,804
Total	$59,507,717	$39,983,262

The cost of reproduction of these facilities as of August 31, 1950 was approximately 5% less than on May 31, 1951.

The "sound value" of Newport's steel facilities on August 31, 1950 was approximately $37,000,000.

The Detroit Plant

102. In the nine months ending July 31, 1950 Newport had lost $63,933 on the Detroit property.

103. Under the lease entered into between Newport and the Government in August, 1950, which provided for an annual rental of $165,000, the net annual income to Newport after deduction of property taxes and insurance but not income taxes, would be $132,600.

104. If the Government, on August 31, 1950, had exercised its option to purchase the property for $1,500,000, minus $191,000 of prepaid restoration charges, the net proceeds to Newport would have been $1,073,658, after deduction of capital gains tax at the rate of 25%.

Universal Cooler Division

105. The earnings, before taxes, of Newport's Universal Cooler Division in its business years 1948 and 1949 and in the ten months ending August 31, 1950 were:

Years	Amounts
1948	($643,261.02) Loss
1949	37,295.92
1950 (10 months ending Aug. 31, 1950)	112,767.11

106. Newport's Universal Cooler Division plant, property, equipment plus inventory had a book value as of August 31, 1950 of $2,718,051. Prior to August 31, 1950, Newport planned to sell this Division, and had made serious attempts to sell it. On October 31, 1950 Newport's new management sold the Universal Cooler Division for slightly more than its then book value. If the additions to book value between August 31, 1950 and October 31, 1950 were deducted from the sales price, Newport received for the Universal Cooler Division slightly more than its book value as of August 31, 1950.

Caswell-Runyan Division

107. The earnings, before taxes, of Newport's Caswell-Runyan division in its business years 1948 and 1949 and in the ten months ending August 31, 1950, were:

Years	Amounts
1948	$195,180.21
1949	124,421.09
1950 (ten months ending Aug. 31)	580,342.88

The earnings, before taxes, of Newport's Caswell-Runyan division in each of the first ten months of its business year 1950 were:

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November 1949	$ 91,298.33
December 1949	34,233.97
January 1950	31,973.68
February 1950	9,267.74
March 1950	12,214.56 (loss)
April 1950	31,434.52
May 1950	88,688.13
June 1950	92,088.09
July 1950	10,890.76
August 1950	196,793.23

108. There was no substantial change in the operators, facilities, or market position of this division between January 1, 1948 and August 31, 1950.

The Steel Division

109. Considering the condition of business generally, and the impact of the Korean war (beginning on June 25, 1950), it was reasonable to estimate in August, 1950 that the steel industry would produce at or above capacity for a minimum of two years, and probably for a longer period.

110. The earnings, before taxes, of Newport's rolling mill division in its business years 1948 and 1949 and in the ten months ending August 31, 1950, were:

Year	Earnings before Taxes
1948	$1,907,925.17
1949	510,402.05
1950 (ten months ending August 31)	271,846.59

111. The monthly sales and earnings before taxes of the rolling mill division November, 1948 through August, 1950, were:

Month	Net Sales	Profit before Taxes
November, 1948	$3,377,475.42	$415,069.60
December	3,359,970.91	351,111.37

Month	Net Sales	Profit before Taxes
January, 1949..	3,785,863.62	339,401.93
February	3,312,710.27	319,368.51
March	3,069,271.24	292,807.67
April	2,323,597.29	121,865.99
May	1,785,394.83	81,918.64 (loss)
June, 1949	1,662,869.73	304,418.45 (loss)
July	1,419,692.75	330,305.04 (loss)
August	1,839,328.60	241,181.33 (loss)
September	1,284,191.	129,683. (loss)
October	2,813.	241,716. (loss)
November	1,191,356.	266,024. (loss)
December	2,122,654.	205,274. (loss)
January, 1950 .	2,675,391.	21,775.
February	1,991,305.	119,018. (loss)
March	2,355,235.	95,179. (loss)
April	2,573,165,	145,473.
May	2,976,165.	131,180.
June	3,530,782.	353,885.
July	2,005,383.	20,653.
August	3,724,732.	284,375.

The division was completely shut down in October, 1949, by a strike, and partially shut down in July, 1949 and July, 1950 for employee vacations.

112. The earnings, before deduction of general expenses and taxes, of the "old steel facilities" of Newport's rolling mill division were:

In April, 1950	$189,407
In May, 1950	244,047
In June, 1950	408,520
In August, 1950	331,559

The average monthly earnings during these four months were $293,383.

113. The production of the "old facilities" of carbon, silicon, alloy and coated sheets remained on approximately

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the same level throughout April, May, June and August, 1950. July, 1950, was a vacation month and the "old facilities" were shut down for two weeks during the month. As between June and August, 1950, production was higher in August in the case of each of the type of sheets produced by the "old facilities." Production of the open hearth furnaces also was slightly higher in August.

114. The earnings, before deduction of general expenses and taxes, of the "new steel facilities" of Newport's rolling mill division were:

June, 1950	$ 67,794.00
August, 1950	111,991.00

115. If the electric furnaces which comprise part of the "new facilities" were to produce their "normal" monthly production of 22,000 tons and all of this production were utilized in the strip mill, Newport would then have 18,700 tons of hot strip and coil to sell. If this amount were sold at the price of $80 per ton in effect on August 31, 1950 the total sales would be $1,496,000. In producing this amount of strip and coil Newport would probably incur costs in the amount of $1,334,273, leaving a monthly profit of $161,727.

116. Up to August 31, 1950 $491,763 had been spent on the pipe mill.

117. Although it had been estimated that the pipe mill would earn between $100,000 and $150,000 per month when operating at a normal rate, there is no evidence as to when normal production might have been expected as of August 31, 1950.

118. Although there is evidence that Newport's steel facilities might be improved or its capacity expanded by changes in or additions to the facilities, any extra values

which may attach to its capital stock because of these possibilities are so speculative in nature as to be beyond reasonable possibility of computation.

119. From September 15, 1947 to August 31, 1950 Newport paid no dividends on its stock.

120. The 398,927 shares of Newport stock sold to Wilport as of August 31, 1950, had a fair value as a control block of $20 per share. What value the block would have had if shorn of its appurtenant power to control distribution of the corporate product, the evidence does not show.

IX.

RATIFICATION

121. Under date of September 14, 1950, Newport sent a letter to its stockholders, signed by Frank S. Gibson, its president, to inform the stockholders of recent developments. This letter contained the following statements:

> "On August 31, 1950, Wilport Company purchased approximately 400,000 shares of common stock of Newport Steel Corporation. Included among the shares purchased were shares owned or controlled by Mr. C. Russell Feldmann and members of his family. Wilport is a corporation owned by a diversified group of manufacturing companies, all of whom use steel in their own manufacturing operations, and all of whom have indicated their intention to remain or become customers of Newport Steel Corporation and to purchase steel from it at the same prices and on the same terms as other customers.
>
> "At a meeting of the Board of Directors of the Company following such purchase, Mr. Feldmann and the other four directors resigned, and by Board action were replaced by Frank S. Gibson, Jr., Wil-

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liam J. Mericka, Bernard A. Mitchell, Frank M. Cobourn and Glenn G. Paxton, who were suggested for the office by Wilport Company. The new Board elected Mr. Gibson Chairman of the Board and President, to succeed Mr. Feldmann; Mr. Mericka Vice President and Chairman of the Finance Committee; and Mr. Paxton Secretary of the Company."

122. This letter was not sent to Newport's stockholders of record as of January 19, 1951. There is no evidence that any of the stockholders of Newport as of January 19, 1951, with the exception of those in the Wilport group, had received or were aware of the letter of September 14, 1950.

123. Under date of January 19, 1951, Newport's management sent out to its stockholders a Proxy Statement which contained the following statements:

"On August 31, 1950, Wilport Company purchased 398,927 shares of the common stock of the corporation. At a meeting of the Board of Directors following such purchase, Frank L. Taylor, A. F. Lorenzen, Joseph V. McKee, Jr., Daniel Scheaffer and C. Russell Feldmann, all of whom were elected directors at the last annual meeting of the stockholders, resigned and were replaced in turn by successive resolutions of the Board, by Frank S. Gibson, Jr., Glenn G. Paxton, Frank M. Cobourn, William J. Mericka and Bernard A. Mitchell. At the meeting, the resignations of C. Russell Feldmann as President, William A. Alfs as Vice President and General Counsel, and H. E. Hamilton as Secretary, were also accepted. George H. Roderick was elected a director to fill the vacancy caused by the subsequent resignation of Glenn G. Paxton, on November 28, 1950. The principal officers of the corporation, who have been elected on or since August 31, 1950, are: Frank S. Gibson, Jr., Chairman of the Board of Directors and President; William J. Mericka, Vice President and Chairman of the Finance Committee; Bernard A. Mitchell,

Vice President; Frank M. Cobourn, Secretary and General Counsel; and H. E. Hamilton, Treasurer and Assistant Secretary.

"Wilport Company is a corporation owned by a group of manufacturing companies, all of whom use steel in their own manufacturing operations. Beginning with small quantities in the month of October, 1950, and increasing to substantial tonnages in later months as Newport Steel Corporation was able to supply steel to the manufacturing companies who are stockholders of Wilport Company, sales of steel to such companies have been made. Such sales have been at the established mill prices of Newport Steel Corporation, and on its regular terms of payment."

The Proxy Statement disclosed that Gibson, Mitchell, Mericka and Cobourn were also officers or directors of Wilport.

124. Under the same date, January 19, 1950, Newport sent its 1950 Annual Report to its stockholders, which included the following statements:

"On August 31, 1950, Wilport company acquired approximately 400,000 shares of the Company's Common Stock. After the purchase the former directors of the Company resigned and were replaced by Frank S. Gibson, Jr., William J. Mericka, Bernard A. Mitchell, Frank M. Cobourn and Glenn G. Paxton. Glenn G. Paxton has since resigned as Director and Secretary, and was replaced by George H. Roderick as Director, and Frank M. Cobourn as Secretary."

"Suits by Stockholders:

"Several civil actions have been filed and are pending, which are derivative actions brought by stockholders on behalf of the Corporation. None of them seek recovery of money from the Corporation. Some of them seek to recover for the Corporation a part of the price realized by the former President

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and other stockholders from the sale of certain Common Stock of the Corporation."

125. At the annual meeting of Newport's shareholders, held on February 19, 1951, the following resolutions were adopted:

"*Resolved,* by the shareholders of Newport Steel Corporation, that the action of the directors of this corporation in accepting the resignations of certain of the former officers and directors of this corporation and in electing their respective successors, as set forth in the minutes of the meeting of directors held on August 31, 1950, be, and the same hereby is, ratified, approved and confirmed."

"*Resolved,* by the shareholders of Newport Steel Corporation, that the action of the officers and directors in authorizing and approving the sale and delivery from time to time of steel produced by this corporation, at its then prevailing mill prices, to stockholders of Wilport Company, be, and the same hereby is ratified, approved and confirmed."

"*Resolved,* by the shareholders of Newport Steel Corporation, that all the acts of officers and directors of this corporation since the date of the last annual shareholders' meeting held March 27, 1950, be, and the same hereby are ratified, approved and confirmed."

126. At said annual meeting of Newport's shareholders held on February 19, 1951, the following shareholders were present:

Name	Number of Shares Held
W. D. Jefferson, in person	1,000
Wilport Company, by Glenn G. Paxton, Bernard A. Mitchell and William J. Mericka, proxies	398,927
Others, by Frank S. Gibson, Jr., William J. Mericka and H. E. Hamilton, Proxy Committee	464,692

making a total number of 864,619 shares present in person or by proxy out of 1,078,535 shares issued and outstanding and eligible to vote at the meeting. The said H. E. Hamilton was, on February 19, 1951, the treasurer and assistant secretary of Newport.

127. The proxies for the 464,692 shares represented by the "Proxy Committee" (composed of Gibson, Mericka and Hamilton) had been solicited by Newport's management by means of the proxy statement dated January 19, 1951, set forth in Finding 123 above.

128. Neither the letter of September 14, 1950 nor the proxy statement of January 19, 1951, nor the 1950 Annual Report contained any statement as to (a) the price paid by Wilport for the stock it acquired from the Feldmann group, or (b) the fact that the option agreement of August 24, 1950 had contained a promise by Feldmann to "deliver to you, at the time you exercise the option, the resignations of all the members of the Board of Directors of Newport Steel Corp." None of these documents contained any discussion of the possible impact of the stock sale and change of directors on Newport's possible future participation in "Feldmann Plan" activities.

129. Prior to the commencement in this Court of the action entitled "Arthur Kramer, et al., plaintiffs, vs. Newport Steel Corporation, et al., defendants" (Civ. No. 3270), which action was subsequently consolidated in the present action, plaintiffs Arthur Kramer, Isaac Wagner, A. Charles Lawrence, Inger Lawrence, James J. Lawrence, Muriel Lawrence, and Edith Lawrence duly demanded of the directors of Newport that they cause it to institute action on the grounds complained of herein, but the directors of Newport failed and refused to comply with this demand.

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130. Demand by plaintiffs Jane Perlman, Emily Reumert and Harry Mernoff that the directors of Newport cause it to bring suit against the individual defendants on the grounds herein complained of, would have been futile because:

(a) At the commencement of this action by plaintiff Jane Perlman on October 2, 1950, the board of directors of Newport consisted of Frank S. Gibson, Jr., William J. Mericka, Bernard A. Mitchell, Frank M. Cobourn and Glenn G. Paxton. The board has since remained unchanged except that, on November 28, 1950, Glenn G. Paxton was replaced by George H. Roderick.

(b) All of said persons were and are directors of Wilport, except that Roderick became a director of Wilport on June 5, 1951. Gibson, Mitchell, Mericka and Roderick were and are officers of corporations which were and are stockholders of Wilport. Cobourn and Paxton were and are attorneys representing some of said corporations. Mericka and Cobourn conducted the negotiations with Feldmann which resulted in the sale by him of a block of common stock of Newport to Wilport.

(c) All of said directors of Newport participated in the transactions herein complained of and hence it could not reasonably be expected that they would institute and conduct this litigation.

(d) Defendant Newport was caused by said directors actively to oppose the prosecution of this action.

131. Demand by plaintiffs upon the stockholders of Newport to bring this suit would have been futile because:

(a) Under the laws of Indiana (Burns Annot. Indiana Stat., 1948, Sec. 25-208), the directors and not the

stockholders manage the affairs of Newport, including the bringing of action for it. The stockholders as a body cannot by resolution manage Newport or compel its management to bring suit.

(b) Compliance by Newport's management with a stockholders' resolution to bring this action would have left the conduct of the action in hostile hands and it could not have been properly prosecuted.

(c) Efforts to secure action by Newport's stockholders would require a proxy fight with Newport's management. The management controls approximately 37% of Newport's outstanding stock. The remaining stock of Newport is widely dispersed among several thousand shareholders whose identity changes from day to day. The management is in control of Newport's proxy machinery. An attempt by plaintiffs to displace Newport's management would have been unavailing.

CONCLUSIONS OF LAW

1. The court has jurisdiction of the parties and of the subject-matter of the action.

2. The plaintiffs, as stockholders of Newport, have the right to maintain this action in the right and for the benefit of Newport.

3. The power of a control block of stock to control management and particularly the power of such a block to control the distribution of the corporate product, is not a corporate asset but rather an attribute inseparably attaching to the stock which, if it has any effect on value, is an inseparable factor entering into the value of the control block.

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4. On the basis of the facts found, the defendant C. Russell Feldmann breached no fiduciary duties which as officer, director or stockholder he owed to Newport or to other stockholders, either (a) by selling a control block of Newport stock to Wilport or, simultaneously with the sale, (b) by cooperating with Wilport in bringing into office a new board of Newport directors nominated by Wilport and thereby accomplishing an immediate transfer of control to Wilport. Nor did the other defendants breach, or participate in the breach, of any fiduciary duties.

5. Even if Feldmann's conduct in cooperating to accomplish a transfer of control to Wilport immediately upon the sale constituted a breach of a fiduciary duty to Newport, no part of the moneys received by the defendants in connection with the sale constituted profits for which they were accountable to Newport.

6. Feldmann's conduct, if held to be a breach of fiduciary duty, was not ratified by Newport's stockholders.

7. The defendants are entitled to a dismissal of the action on its merits, with their costs.

Dated at New Haven this 8th day of December, 1952.

C. C. HINCKS
United States District Judge

COPY

FILED
MAY 31 1955
HAROLD B. WILLEY, Cle

IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No. 743

C. RUSSELL FELDMANN, CHARLOTTE M. FELDMANN, JOSEPH V. McKEE, JR., CAROLYN OTTO, PHYLLIS McKEE and BARBARA JANE FELDMANN,

Petitioners,

—against—

JANE PERLMAN, ARTHUR KRAMER, INGER LAWRENCE, MURIEL LAWRENCE, A. CHARLES LAWRENCE, INGER LAWRENCE, MURIEL LAWRENCE, EDITH LAWRENCE and JAMES J. LAWRENCE, as joint tenants with right of survivorship, ISAAC WAGNER and HARRY MERNOFF,

Respondents.

PETITIONERS' REPLY BRIEF IN SUPPORT OF A PETITION FOR A WRIT OF CERTIORARI

ARTHUR H. DEAN,
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Of Counsel.

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IN THE

Supreme Court of the United States

October Term, 1954

No. 743

J. RUSSELL FELDMANN, CHARLOTTE M. FELDMANN, JOSEPH V. McKEE, JR., CAROLYN OTTO, PHYLLIS McKEE and BARBARA JANE FELDMANN,

Petitioners,

—against—

JANE PERLMAN, ARTHUR KRAMER, INGER LAWRENCE, MURIEL LAWRENCE, A. CHARLES LAWRENCE, INGER LAWRENCE, MURIEL LAWRENCE, EDITH LAWRENCE and JAMES LAWRENCE, as joint tenants with right of survivorship, ISAAC WAGNER and HARRY MERNOFF,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO A WRIT OF CERTIORARI

Petitioners have sought a writ of certiorari to review an interlocutory decision of the United States Court of Appeals for the Second Circuit (Clark and Frank, *JJ.;* Swan, J., dissenting*), which reversed a judgment of the District Court.

The case presents no federal question. Petitioners concede it is governed by the law of Indiana. The Court below held that under Indiana law (which does not differ

* The dissenting judge did not hear the argument. He was substituted several months after the argument, by consent of the parties, when Judge Learned Hand decided to disqualify himself.

from the law in other states) petitioners are liable. Petitioners contend that Indiana law requires a different conclusion, but have produced no cases supporting such contention.

Question Presented

On the facts was the Court below warranted in applying the familiar principle that a corporate fiduciary who uses his corporate power and position for his personal gain to the detriment of the corporation must account for his profits?

Statement

Since petitioners' "Statement" omits reference to the very facts on which the decision of the Court of Appeals rests—the facts showing that petitioner Feldmann, in selling his controlling stock of Newport, sacrificed the interests of Newport—we must supply those facts in their context.

The parties

Respondents (plaintiffs below) own 5,536 shares of stock of Newport.

The principal defendant, petitioner C. R. Feldmann, was during the times in question president, chairman of the board of directors and controlling stockholder of Newport, an Indiana corporation. The other petitioners were members of Feldmann's family. Represented by Feldmann, they participated in the transaction complained of (Findings 65, 73, 64a-65a, 67a*).

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* References marked with a lower case "a" relate to pages of the Appendix filed by plaintiffs in the Court of Appeals. References marked with a capital "A" relate to the Opinion of the Court of Appeals attached to petitioners' Petition for a Writ of Certiorari.

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Feldmann and his family at the time of the commencement of the transaction held 33% of Newport's outstanding shares. The remaining shares—over 735,000—were widely distributed among several thousand stockholders (Findings 6-9, 45a-46a).

Nature of Newport's business and needs

Newport in 1950 was engaged chiefly in the production of steel. Originally a phonograph and radio company, it had first entered the steel business in 1946, buying an old steel mill "capable only of high cost operation" (Finding 21, 49a). During the succeeding years Newport had gradually enlarged and improved its steel facilities. The development of Newport as a steel producer had been made possible by the periodic and extreme steel shortages during the post-war years. Newport (under Feldmann's management) had used the shortages to obtain large interest-free loans and substantial premiums from customers needing steel in their business; in return therefor Newport undertook to deliver to these customers large quantities of its steel output over extended periods at the prices prevailing at the time of delivery. This cost-free method of raising funds for improving facilities in time of steel shortage in return for commitments to sell steel became known and widely used in the steel industry under the name "Feldmann Plan" (Finding 44, 57a-58a).

During the period from 1946 to 1949 Feldmann had on eleven occasions successfully negotiated such interest-free advances and premiums for Newport in return for commitments of its steel production. These advances to Newport aggregated $13,510,000 (Findings 38-40, 55a-77a). They constituted the principal source of the funds with which Newport paid for its steel manufacturing facilities.

In August 1950, Newport's steel facilities were still so marginal, inadequate and unintegrated that only in times of extreme shortage could it hope to make a profit. Its costs of production were greater than those of its competitors. In normal times sale of its steel was feasible only in the local area where freight considerations might balance off higher costs (Findings 34, 54a). Moreover, Newport's steel production consisted chiefly of "hot rolled" sheets and coil, a type of steel that was being replaced in the industry by the finer "cold rolled steel"—which required further processing of the hot rolled product (Findings 21-23, 32, 45, 49a-51a, 53a, 58a, 116a, 130a; Pl. Ex. 38, 180a-181a). The trial Court found that with existing facilities there was "scant ground for inference of profits from the steel division under any conditions other than those of an outright boom" (Op. 42a).

Newport's opportunity of competing successfully when normal times returned depended upon improving its steel product through the acquisition of "cold rolling" facilities to further process the hot rolled steel it produced (Pl. Ex. 38, 179a-180a).

Since Newport had no funds to buy cold-rolling equipment (Findings 46, 58a), it engaged from May to July 1950 in merger negotiations with another steel company which owned a cold-rolling mill. With the beginning of the Korean hostilities (June 25, 1950) Feldmann's attitude toward the merger cooled, and he suspended the merger talks in July 1950 (Finding 47, 58a-59a).

Steel shortage resulting from Korean hostilities

The outbreak of the Korean conflict created an extreme steel shortage (Findings 109, 78a). "Steel producers were in a position to exact for their product from hungry end

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users of steel a price premium over and above prices fixed on the basis of their mill costs" (Op. 18a). No legal limitation on steel prices existed in 1950 (Op. 18a). While most domestic steel producers adhered to their own published prices *on ordinary sales*, the amount of steel they were willing to sell in this manner to civilian users was inadequate to their needs.

This renewal of the post-war steel shortages prepared the soil for renewing the use of "Feldmann Plan" financing. Newport was in a favorable position to obtain funds on this basis, for only a third of its expected production was committed (Finding 79, 69a). During this very period, to Feldmann's knowledge, several of the most reputable steel producers obtained from customers large interest-free "Feldmann Plan" loans on favorable terms to be used in improving their steel facilities, in return for committing part of the steel production to these customers (Finding 86, 71a).

After the beginning of the Korean hostilities, Feldmann admittedly made no effort to find out what could be done for Newport along the lines of raising funds to improve Newport's steel facilities by the use of Feldmann Plan financing (Finding 88, 71a). Instead, Feldmann, his family and fellow directors undertook a final, self-serving transaction, which the Court of Appeals correctly characterized as "siphoning off for personal gain corporate advantages to be derived from a favorable market situation" (A-8).

Deal with the Wilport group

In August 1950 Feldmann had a three-fold fiduciary responsibility to Newport; he was president, director and controlling stockholder of the company. While serving in

those fiduciary roles, Feldmann for a private consideration transferred Newport's entire uncommitted steel supply to a distant group of end users (Wilport), who during the shortage needed steel for their personal use. Since the Wilport group were paying to obtain steel for their immediate personal use, Feldmann's act terminated the possibility of deploying Newport's uncommitted steel supply for the corporate benefit either by obtaining Feldmann Plan interest-free loans needed for acquiring cold rolling facilities or by building up good will in the area where in normal times Newport might hope to compete (see A-9–A-10; Findings 34, 53, 91, 92, 54a, 61a, 72a).

Feldmann's transfer of Newport's steel in short supply was *not* made in the exercise of a disinterested fiduciary discretion. He was paid handsomely for his sacrifice of the corporation's interests, as the following facts show:

On August 24, 1950 Feldmann undertook to transfer control of Newport and its steel supply—including its entire board of directors—on payment of $20 per share for the block of shares which he controlled (Finding 65, 65a). The price of $20 per share was more than twice the market when the deal was negotiated, and twice what the stock had ever before sold for (see *infra* p. 9). The total payment received by Feldmann ran to about $8,000,000.

Feldmann expressly undertook in writing "to deliver * * * the resignation of all members of the board of directors of Newport" (Pl. Ex. 4, 158a), and the oral understanding (as the trial Court found) was that he would procure the election of the purchasers' nominees (Op. 27a; Finding 64, 64a).

"The immediate resignation of the officers and directors of Newport," as the trial Court expressly found, "was im-

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portant to the purchasers of Feldmann's stock, in order to make available to themselves as soon as possible the maximum amount of steel from Newport" (Finding 84, 70a; see also Finding 70, 66a).

Before the closing, the original purchasing group enlarged its membership to sixteen, raising the required fund to pay Feldmann by an agreement to apportion among the participants calls upon Newport's uncommitted steel supply in precise proportion to the amount which each contributed to buy out Feldmann (Finding 68, 65a-66a; Pl. Ex. 10, 170a).

As stated by the representative of the purchasing group, the availability of steel to the members of the group "was the *one* thing that motivated the interest in investing $8,000,000 or more" to buy out Feldmann (100a-101a).

The District Court found (Finding 53, 61a):

> "53. The dominant motive of the purchasing group in seeking to purchase Feldmann's controlling stock interest in Newport was to obtain a continuing source of steel supply. Feldmann knew during the negotiations that such was their motive."

In the preliminary negotiations Feldmann used his position as president to have employees of Newport make available to representatives of the proposed purchasing group confidential corporate data as to existing steel commitments and their expiration dates, and even had the plant manager prepare and turn over a schedule of Newport's uncommitted steel production for the year 1950.

The purchasing group consisted of manufacturers with plants remote from Newport; none was within the 150-mile area that would make it a natural customer of Newport in

normal times, and some were as far as 750 miles away (Findings 23, 34, 92, 50a, 54a, 72a). Their only possible interest in Newport was to obtain steel during the period of shortage when they could not secure sufficient steel from their normal suppliers.*

To make the maximum profit from the transaction, and since the agreement gave Feldmann the right to have the purchasers take up to 400,000 shares, Feldmann caused his family to make additional purchases on the market and from certain friends (Finding 96, 73a; 107a-108a).

Feldmann testified that these friends asked him to fix a "fair price" for the Newport shares which Feldmann proposed to purchase. As to the shares of two of these friends he fixed the fair price as $10 per share. But as to a third friend who was one of the directors, and whose resignation he required to put through the deal, Feldmann fixed the price as $12 per share (Findings 98, 74, 74a, 67a).

All of these shares, title to which was taken in the name of Feldmann's family and associates, Feldmann turned over to the buying group a couple of days later for $20 per share (109a-110a). Feldman's own conduct thus shows that he regarded Newport stock—as stock—to have a fair value of no more than $10 per share.

On the closing Feldmann provided the resignation of all officers and directors. This was handled in such a manner that as each director resigned a new director nominated by the purchasing group was successively elected. Feldmann was the last director to resign and voted for all the

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* Petitioners themselves admit that the Wilport group disposed of their stock in Newport as soon as the steel shortage ended (Pet. p. 4). This was foreseeable and was predicted by respondents at the trial.

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directors supplied by the purchasing group except the director who replaced him (Finding 74, 67a-68a).

That the purchasers' sole interest was to obtain steel for themselves was further made clear by the fact that they required from Feldmann no warranty or representation of Newport's financial condition but only a warranty as to Newport's steel commitments (Finding 70, 66a).

Feldmann admitted his realization that the purchasing group was "interested in buying stock in order to obtain a source of steel supply" (Finding 53, 61a, 104a), that his price would not have been paid by "one not interested in securing a source of steel supply," and that *he considered the price "a combination of both factors, investment value and ability to obtain a source of steel supply"* (105a).

The price paid Feldmann was more than twice the "broad, fair and active market" on which the trial Court found the stock had been selling at the time of the agreement. It was more than twice what the stock had ever sold for before, and twice what Feldmann had fixed as the "fair price" for the shares his friends sold to his family. The $20 price was also more than twice any valuation that could be reached by capitalizing Newport's profits on the price-to-earnings ratio at which far superior steel companies like U. S. Steel, Bethlehem Steel, and Republic Steel were currently selling on the New York Stock Exchange (Pl. Ex. 18; Findings 6, 8, 96, 98, 45a, 46a, 73a, 74a, 117a-118a, 137a-140a; Pl. Ex. 30, 175a; Defts. Ex. 54, p. 1, 190a-191a).

The transfer of control of Newport's management and steel supply was carried out without notice to the stockholders. By this transaction Feldmann vested control of Newport's steel supply in a group which he knew to be committed to the application of such steel supply for their own

private purposes during the shortage. He thereby deprived the corporation of a management which could disinterestedly consider what use could best be made by the corporation of its temporarily favorable economic position, and diverted to his private profit corporate rights and advantages.

Subsequent events

Petitioners have gone outside the record to call attention to the fact that during the pendency of the appeal the Wilport Company sold its shares to Merritt-Chapman & Scott Corporation (Pet., p. 4).

It should be noted that by this sale, which occurred at the end of 1953, the Wilport group (1) immediately upon the end of the steel shortage hastened to rid itself of its Newport stock; (2) could get for its 37% control block only the equivalent of about $10 per share (approximately the then market price), or half of what they had paid Feldmann; and (3) did not receive a higher per share price for their control block than what Merritt-Chapman by the same agreement offered simultaneously to all other stockholders of Newport.*

This confirms—what was fully established at the trial—that what Feldmann got in excess of the market was paid not because his stock was worth more, but because he exacted a premium as a price for making Newport's steel available during the shortage to a group of steel-hungry end-users.

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* This appears from a Prospectus filed with the Securities and Exchange Commission and sent in January 1954 to all stockholders.

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Petitioners' misconception of the decision of the Court of Appeals

In an effort to whet this Court's interest, petitioners take extravagant liberties both with the authorities and with the opinion below, stating (Pet., p. 3):

> "The Court of Appeals has held, contrary to every court decision on the question, that corporate stock and the voting rights appurtenant thereto are not the sole property of the stockholder who owns the stock. It held that when the number of shares owned is sufficient to control the corporation and control is valuable, a controlling stockholder who sells his outstanding stock must share with the other stockholders that part of the sales price which represents the value of control."

As if to prevent any such distortion of its holding, the Court of Appeals said in plain language, after pointing out how Feldmann had misused his position to the detriment of the corporation and turned a corporate advantage into a private profit:

> "We do not mean to suggest that a majority stockholder cannot dispose of his controlling block of stock to outsiders without having to account to his corporation for profits or even never do this with impunity when the buyer is an interested customer, actual or potential, for the corporation's product. But when the sale necessarily results in a sacrifice of this element of corporate good will and consequent unusual profit to the fiduciary who has caused the sacrifice, he should account for his gains. So in a time of market shortage, where a call on a corporation's product commands an unusually large premium, in one form or

another, we think it sound law that a fiduciary may not appropriate to himself the value of this premium. Such personal gain at the expense of his co-venturers seems particularly reprehensible when made by the trusted president and director of his company" (A-11).

The Court therefore held that "to the extent that the price received by Feldmann and his co-defendants included such a bonus, he is accountable" (A-11).

POINT I

Feldmann violated his fiduciary duties.

1. It is elementary that Feldmann, as the chief executive, director and controlling stockholder of Newport, stood in a fiduciary relation to the corporation. *Pepper* v. *Litton,* 308 U. S. 295, 306, 311 (1939). Each of these three positions made Feldmann a fiduciary; their combination in his hands gave him nearly untrammeled powers over Newport's fate, accentuating the strictness of his responsibilities. His was an obligation of "absolute and most scrupulous good faith"; he could not, "in any degree, allow his official conduct to be swayed by his private interest, which must yield to official duty." "Directors of a business corporation act in a strictly fiduciary capacity. Their office is a trust." (*Schemmel* v. *Hill,* 91 Ind. App. 373, 169 N. E. 678, 682-3; *Hill* v. *Nisbet,* 100 Ind. 341, 353.)

As stated in *Pepper* v. *Litton,* 308 U. S. 295:

> "A director is a fiduciary. *Twin Lick Oil Co.* v. *Marbury,* 91 U. S. 587, 588. So is a dominant or controlling stockholder or group of stockholders. *Southern Pacific Co.* v. *Bogert,* 250 U. S. 483, 492. *Their powers are powers in trust* (p. 306). (Italics ours.)

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> "* * * He who is in such a fiduciary position cannot serve himself first and his *cestuis* second. * * * He cannot use his power for his personal advantage and to the detriment of the stockholders and creditors no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements. For that power is at all times subject to the equitable limitation that it may not be exercised for the aggrandizement, preference, or advantage of the fiduciary to the exclusion or detriment of the *cestuis*" (p. 311).

In Indiana, as elsewhere, "the responsibility of the fiduciary is not limited to a proper regard for the tangible balance sheet assets of the corporation, but includes the dedication of his uncorrupted business judgment for the sole benefit of the corporation, in any dealings which may adversely affect it" (Clark, *J.*, A-7). That such was the measure of Feldmann's duties was recognized even in Judge Swan's dissenting opinion below (A-12).

Against this legal background, the facts inevitably spell Feldmann's liability. The steel shortage occasioned by the outbreak of the Korean conflict afforded Newport valuable opportunities for gain, either by resuming its traditional policy of Feldmann plan financing (which at that very time was being utilized by several other reputable steel companies) or by building customer good will within the geographical area in which freight savings might, upon the return of a normal market, enable it to compete with the low cost product of other steel producers. "Either of these opportunities was Newport's, to be used to its advantage only" (Clark, *J.*, A-10). Had Feldmann, in the exercise of disinterested business judgment, refrained from embracing these opportunities, he might have been within

his rights. But Feldmann's judgment was corrupted by the promptings of self-interest. Instead of exploring the possibilities of new Feldmann plan financing, he utilized the opportunities offered by the steel shortage for his own benefit through the device of selling his control stock, at a premium price, and immediately transferring management to buyers whose predetermination to take Newport's product for themselves precluded any hope for Newport to turn those opportunities to its own advantage. In effect, he sold a call on Newport's steel supply (A-11). By thus sacrificing Newport's rights and opportunities for his private gain, Feldmann acted in the teeth of his fiduciary duties. It is this breach which renders him accountable.

2. Petitioners urge the absence of proof that Newport's loss of these opportunities resulted in computable damage. But damage to the *cestui* is not a necessary element of fiduciary accountability. Once the breach of fiduciary duties is established—as it is here—it is fundamental that the fiduciary must account for the profits derived from his breach, no matter whether or not his *cestui* has sustained a demonstrable pecuniary loss. *Magruder* v. *Drury*, 235 U. S. 106, 119-120:

> "It is a well-settled rule that a trustee can make no profit out of his trust. The rule in such cases springs from his duty to protect the interest of the estate, and not to permit his personal interest to in any wise conflict with his duty in that respect. * * * It makes no difference that the estate was not a loser in the transaction."

This principle has been applied in a variety of situations involving corporate fiduciaries.

Thus if a corporate director accepts pay for resigning or for appointing a successor in office, the corporation is en-

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titled to an accounting for the amount received, regardless of any injury resulting. *West* v. *Camden,* 135 U. S. 507 (1890); *McClure* v. *Law,* 161 N. Y. 78 (1899); *Forbes* v. *McDonald,* 54 Cal. 98 (1880).

A stockholder accepting payment for casting his vote or for giving his proxy is accountable to the corporation although it suffered no loss. *Macht* v. *Merchant M. & C. Co.,* 22 Del. Ch. 74, 80 (1937); *Brady* v. *Bean,* 221 Ill. App. 279, 283-4 (1921).

In *Moulton* v. *Field,* 179 Fed. 673 (C. A. 7, 1910), the directors of an insurance company permitted one Gray, who held a management contract with the corporation, to sell that contract to a third party for $125,000. Although there was no corporate loss, the directors were held liable (p. 675):

> "If the succession was worth $125,000 in the market, the sale * * * should have been made by the directors for the benefit of the owners of the business, not of Gray."

A stockholder bringing a derivative action occupies a fiduciary relation to the corporation and the other stockholders. If he settles the case by selling his stock at a premium, he is accountable for that premium, no matter whether the action could have been successful. *Clarke* v. *Greenberg,* 296 N. Y. 146 (1947); see *Young* v. *Higbee Co.,* 324 U. S. 204 (1945); *Young* v. *Potts,* 161 F. 2d 597 (C. A. 6, 1947).

The rule that proof of corporate damage is no prerequisite of fiduciary liability has been consistently applied in those cases where directors diverted corporate rights or opportunities to themselves. In *Irving Trust Co.* v. *Deutsch,* 73

F. 2d 121 (C. A. 2, 1934), cert. den. 294 U. S. 709, corporate directors who bought stock for themselves rather than for the corporation were held accountable for their profits even though they acted in good faith and there was proof that the corporation did not have the financial means to acquire the stock itself. In *Pratt* v. *Shell Petroleum Corp.*, 100 F. 2d 833 (C. A. 10, 1938), a corporation engaged in the business of acquiring oil leases employed the defendant as a geologist; the defendant, having acquired oil leases for himself, was held accountable:

> "It was not necessary for plaintiff to show that it suffered detriment, injury or damage. * * * a court of equity does not concern itself with the question whether * * * the principal suffered actual injury" (100 F. 2d, at 837-8).

The Court below was therefore fully justified in holding that "The corporate opportunities of whose misappropriation the minority stockholders complain need not have been an absolute certainty in order to support this action against Feldmann. If there was possibility of corporate gain, they are entitled to recover" (A-8).

3. Petitioners in effect argue that the fiduciary principle, however broad and sweeping, is subject to an exception if the fiduciary sells stock, *i.e.* that, where the fiduciary is in a position of absolute control (as chief officer, dominating director and dominant stockholder), he is exempted from equitable principles provided he siphons off the profit by the device of a sale of his control block and transfer of management.

The fiduciary rule of undivided loyalty cannot thus be undermined by "the disintegrating erosion of particular exceptions" (Cardozo, *J.*, in *Meinhard* v. *Salmon*, 249 N. Y.

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458, 464 [1928]). It is true, of course, that in *ordinary circumstances* the sale by a director to another of corporate stock will not affect the corporate interests; the transaction then offers no occasion for invoking the fiduciary principle. But the rule is otherwise where—as here—the sale of a large block of stock at an excessive price is a device for transferring what belongs to the corporation and impairs the interests of the corporation. If the seller of such stock stands in a fiduciary role as director and controlling stockholder, reason and authority require that he be held accountable. That the transaction is effected through a stock sale does not relieve the fiduciary of liability; *Wood* v. *Manchester Fire Ass. Co.*, 54 App. Div. 522, 523-4 (1st Dept., 1900):

> "* * * shareholders have the right to sell their stock, and at any stockholders' meeting to vote and act in the interest and protection of their own pecuniary requirements. * * * But when a stockholder accepts the trusteeship of a corporation, and becomes director and president, the freedom of his right of action as a stockholder is fettered by the lines of his trust duty. It is a voluntary thing for him to assume such a position, but, once accepted, paramount duties flow from the responsibility which he takes."

The rule finds its most elementary application where a fiduciary for a consideration sells stock and transfers directorates with notice that the purchasers are interested in diverting the corporate assets to themselves. The seller must then account for the corporation's damage as well as his own profits. *Insuranshares Corp.* v. *Northern Fiscal Corp.*, 35 F. Supp. 22, 25 (D. C., E. D. Pa., 1940):

> "Those who control a corporation * * * owe some duty to the corporation in respect of the transfer of

the control to outsiders. The law has long ago reached the point where it is recognized that such persons may not be wholly oblivious of the interests of everyone but themselves, even in the act of parting with control * * * "

Accord:

Gerdes v. *Reynolds*, 28 N. Y. S. 2d 622, 30 N. Y. S. 2d 755 (S. Ct., N. Y. Co., 1941);
Ballantine v. *Ferretti*, 28 N. Y. S. 2d 668 (S. Ct., N. Y. Co., 1941);
Dale v. *Thomas H. Temple Co.*, 186 Tenn. 69, 208 S. W. 2d 344 (1948).

The corporate wrong arising from the device of a sale of control stock may take forms less obvious and blatant than the outright looting of corporate assets by the purchasers. Thus in *Commonwealth Title Ins. & Trust Co.* v. *Seltzer*, 227 Pa. 410, 76 Atl. 77 (1910), the defendant, president of a corporation, was approached by another organization wishing to acquire the corporate real estate. The defendant, together with another director, arranged for the sale of their control block of stock at a substantial profit. Having obtained control, the purchaser then bought the real estate from the corporation at a price "which was found not to be inadequate" (227 Pa., at 415). Nevertheless, the court held the sellers accountable for the profits derived from the stock sale (227 Pa., at 416-7):

"These defendants as managing officers were under an inherent obligation not to in any manner use their positions to advance their individual interests as distinguished from the interests of their corporation. When the president of this corporation was approached by a likely buyer, * * * he should have overlooked his

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> own welfare and acted entirely for the benefit of his corporation. * * * In scrutinizing the acts of such officers, the Court will not heed mere form when the substance that lurks behind them shows profits from a dealing in the corporation property."

In *Seltzer* then, the sale of control stock did not result in demonstrable injury to the corporation or in the looting of its assets. The purchasers of the control stock bought the corporation's real estate at an adequate price. But the sale of the control stock by the corporation's fiduciary prevented the corporation from utilizing its bargaining power to its full extent; and that was enough to make the fiduciary accountable for his profit. The analogy of *Seltzer* to the case at bar requires no elaboration. Here, too, the buyers of Feldmann's control stock did not loot Newport's assets; for the steel they diverted from Newport they paid mill prices—which they themselves fixed. But Feldmann's sale necessarily foreclosed Newport from the opportunity of deriving benefits offered by the 1950 steel shortage. Since Feldmann cut off Newport's opportunity, and, to the exclusion of the other stockholders, turned Newport's steel supply to his private benefit through the sale of management, he must account for his resulting profits.

In *Porter* v. *Healy,* 244 Pa. 427, 91 Atl. 428, 432, where a special payment was made in connection with a stock sale, for transfer of directors, the court held that the sellers must account for so much as was paid them for transferring control rather than for their stock. See also *Seagrave Corp.* v. *Mount,* 212 F. 2d 389, 396-7 (C. A. 6, 1954).

In *Ballantine* v. *Ferretti,* 28 N. Y. S. 2d 668, 680, where the controlling stock was sold with the immediate substitution of directors, the court held that the fiduciaries must account for so much of the price they received as exceeded

the fair price of the stock as stock, even though the corporation whose control was transferred was in no way damaged. Accord: *Gerdes* v. *Reynolds,* 30 N. Y. S. 2d 755, at 779.

There is no lack of additional instances in which the sale of corporate stock was held to render the seller accountable for his profits, despite the lack of demonstrable damage to the corporation. Thus, a stockholder who has brought a derivative action or similar proceeding on behalf of his corporation or his co-stockholders, is free to sell his stock although the sale will terminate his right to maintain the action. But in selling his stock the stockholder-plaintiff cannot, under the guise of getting a higher price for the stock, accept a premium for the surrender of the action which he brought in the right of the corporation or the other stockholders. If he does, he must account for the premium, even though there is no proof at all that the action could ever have been successful.

This court so held in *Young* v. *Higbee Co.,* 324 U. S. 204 (1945), where Black, *J.* wrote (pp. 212-3, note 12):

> "By virtue of their standing as sole appellants, Potts and Boag, during the pendency of the appeal dominated the fate of the reorganization as completely as though they had been the majority stockholders of a going corporation. Cf. *Southern Pacific Co.* v. *Bogert,* 250 U. S. 483, 492: ' * * * The essential of the liability to account sought to be enforced in this suit lies not in fraud or mismanagement, but in the fact that, having become a fiduciary through taking control of the old Houston Company, the Southern Pacific has secured fruits which it has not shared with the minority.' " (Italics ours.)

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Accord:

Clarke v. *Greenberg,* 296 N. Y. 146, 71 N. E. 2d 443 (1947);
Young v. *Potts,* 161 F. 2d 597 (C. A. 6, 1947).

We submit that Feldmann was properly held accountable for the gain he derived by sacrificing Newport's opportunities. It is no defense that the transaction by which Feldmann achieved his ends was cast in the form of a stock sale.

4. None of petitioners' arguments can detract from this conclusion.

a) Petitioners invoke *S. E. C.* v. *Chenery Corp.,* 318 U. S. 80. The question in that case was simply whether the directors were prohibited from *buying* outstanding stock, in the absence of fraud or overreaching. Of course the Court below fully recognized the principle there stated that stockholders are not precluded "*merely* because they are officers and directors, from buying and selling the corporation's stock." But what was here involved was not a mere stock sale. In such a situation, as shown by the later case of *Young* v. *Higbee Co.,* 324 U. S. 204, the fact that the violation of a fiduciary duty is effected through the device of a stock sale does not relieve the fiduciary of accountability.

b) Petitioners rely on *Board of Commissioners of Tippecanoe County* v. *Reynolds,* 44 Ind. 509 (1873). The case is wholly beside the point. The defendant there, a director, bought stock from the plaintiff without revealing facts known to him regarding the financial condition of the company. In an action which the seller brought in his individual capacity, the Court held that the defendant was not guilty of actionable deceit. There was no claim or proof

that there had been a breach of duty to the corporation; the transaction had resulted in no detriment to the corporation; and the Court drew a sharp distinction between an individual suit for an alleged fraud on an individual stockholder and a wrong to the corporation or the stockholders as a group. While denying a fiduciary relation in the former case, the Court emphasized, "Where the action of the directors has affected the whole body of stockholders, the relation of trustee and cestui que trust has been held to exist" (p. 513). In the case at bar, the duties breached by Feldmann were those which he owed to Newport or the whole body of stockholders, not to any one individual.

Petitioners also cite *Levy* v. *American Beverage Corp.*, 265 App. Div. 208, 38 N. Y. Supp. 2d 517 (1st Dept. 1942). There a majority block of stock was sold above the market (but at a price less than what the seller had himself paid and less than current book value). The Court expressly found that there had been no agreement to secure resignation of directors and no change of directors occurred, except by vote of the new majority at the next regular stockholders' meeting, and further found that the defendant had had neither knowledge nor notice of any threatened detriment to the corporation.

In the present case, Feldmann, who did not have the rights of a majority holder, bargained for the immediate transfer of Newport's directorate as part of the consideration, knowing that new management was required by the buyers to utilize Newport's steel supply for their own advantage (Findings 65, 84, 65a, 70a). Feldmann admitted that part of what he was paid was for making available the steel supply (105a).

c) Petitioners finally argue that Feldmann was under no duty to refrain from selling his 37%-block of stock;

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that the power to control Newport's output and the selection of its customers was an appurtenant of the control block; and that Feldmann could not transfer his stock without simultaneously transferring that power (Pet., p. 15). These statements may be true as far as they go; but they do not reach the issues in this case.

The power to control the corporation (including the power to control its output and to select its customers) is a "power in trust"; "that power is at all times subject to the equitable limitation that it may not be exercised for the aggrandizement, preference, or advantage of the fiduciary to the exclusion or detriment of the *cestui*" (*Pepper* v. *Litton, supra,* 308 U. S. at 306, 311). Where, as here, the purchaser, to the knowledge of the seller, is committed to a policy of turning this "power in trust" to his private advantage, without regard to the corporate interests, and pays a special premium therefor, the seller is in no better position than if he himself had perverted the power to his private benefit. The sale of the stock, with the appurtenant powers then becomes wrongful; and it is idle for the seller to argue that he could not sell the stock without the power.

POINT II

The decision below rests upon the facts found by the District Court or admitted by petitioners and upon the proper allocation of the burden of proof.

Petitioners impute to the Court of Appeals a holding that the mere fact of a fiduciary's sale of control stock casts upon him the burden of negating corporate injury (Pet., p. 20). The Court of Appeals, it is hardly necessary to say, held nothing of the kind. It did not hold that Feldmann must prove the absence of corporate opportunities. The existence of such opportunities and their diversion by Feldmann was found and amply proved (A-9–A-10).

Petitioners contended below that plaintiffs had not definitely proved that in 1950 Newport could have obtained Feldmann Plan loans, although admittedly Newport had done so in previous years when the shortage was less acute, and other steel producers (to Feldmann's knowledge) were doing so successfully at that time (Findings 37-39, 86, 55a-56a, 71a). It was undisputed, and the District Court found, that Feldmann made no effort whatever in 1950 even to explore the possibilities (Findings 88, 89, 71a), and that "considering the past history of Newport's business and the conditions of the steel market as of then, it is not unreasonable to assume that Newport might have been able in July and August, 1950 to make long range contractual commitments (Finding 81, 69a). The Court of Appeals held that under the circumstances the burden was not upon plaintiffs to prove that a Feldmann Plan transaction could have been successfully effected, but on petitioners to prove the contrary—which they had failed to do (A-10).

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It is beyond question that the rule thus applied was correct. *Pepper* v. *Litton, supra* (308 U. S. at 306).* Petitioners would distinguish this and similar authorities on the ground that they involved transactions between the fiduciary and his corporation, whereas Feldmann's transaction was with third parties. But this is an unwarranted distinction. In the corporate opportunity cases—such as *Irving Trust Co.* v. *Deutsch, supra* (73 F. 2d 121), and *Pratt* v. *Shell Petroleum Corp., supra* (100 F. 2d 833)—the fiduciaries likewise dealt with third parties; a rule similar to, if not stricter than that discussed was nevertheless applied. Whether the fiduciary buys property from his corporation at an inadequate price, or whether by dealing with a third party he diverts a corporate opportunity to himself, he is in either event accountable for his profits, at least where he fails to prove that there was no possibility of corporate harm. This burden petitioners failed to sustain.

Petitioners complain that the Court of Appeals, in remanding the case, gave them no further opportunity to meet that burden. There was no reason to do so. The applicable law has long been settled. In fact, this case was tried by both sides to the hilt, both adducing what evidence they could find on the question of feasibility of Feldmann Plan financing. In the District Court, as in the Court of Appeals, we vigorously argued for the burden of proof rule ultimately adopted by the Court of Appeals. At no time did petitioners suggest to that Court that they had any additional evidence to offer on that issue, nor do they even now say so. Petitioners' contention that a new trial should have been ordered of the very issues so thoroughly ventilated in the District Court is nothing but a belated afterthought.

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* See also *Schemmel* v. *Hill*, 91 Ind. 373, 169 N. E. 678, 685; *Zaring* v. *Kelly*, 75 Ind. App. 15, 128 N. E. 657, 658; *Mayflower Hotel Stock P. C.* v. *Mayflower Hotel Corp.*, 173 F. 2d 416, 418-423.

2. According to petitioners, the Court of Appeals "assumed" without warrant that the sales price included a premium for the access to Newport's steel (Pet., pp. 21, 23). But the record and the findings clearly show that "the price received by Feldmann and his co-defendants included such a bonus" (A-11).

Feldmann himself admitted that the price was paid for both stock and steel. He testified in so many words that the price was "a combination of both factors, investment value and ability to obtain a source of steel supply" (105a). He admitted that "a purchaser interested only in investment and not interested in securing a source of steel supply" would not have been willing to pay the price (105a). And the District Court held that "where—as here—because of imbalance between supply and demand, the corporation cannot supply all who are eager to become customers, it is obvious, I think, that the power to control the selection of the customers is a factor adding materially to the value of the block of stock to which the power is appurtenant" (Op. 20a).

Feldmann thus commingled in the purchase price the investment value of his stock and a premium for making available Newport's steel supply. Since Feldmann, under the facts of this case, was not entitled to receive payment for making Newport's steel output available to third parties, the burden was upon him as a commingling fiduciary to show how much he should be allowed to retain as the fair value of his stock. Whatever balance remains is the amount of the extra premium for which he must account.

The rule is thoroughly settled that "where there is commingling of gains, he (the wrongdoer) must abide the consequences unless he can make a separation of the profits

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so as to assure to the injured party all that justly belongs to him"; *Sheldon* v. *Metro-Goldwyn Pictures Corp.*, 309 U. S. 390, 406 (1940). Accord: *Bigelow* v. *RKO Radio Pictures*, 327 U. S. 251, 265 (1946); *Hamilton-Brown Shoe Co.* v. *Wolf Brothers & Co.*, 240 U. S. 251, 259-262 (1916). The law of Indiana follows the same rule where a fiduciary in one consideration commingles proper with improper gains; *Brackenridge* v. *Holland*, 2 Black. (Ind.) 377, 383.

The District Court's finding that Feldmann's stock was worth $20 per share was expressly based upon that Court's erroneous theory that Feldmann was entitled to turn the power over the distribution of Newport's product to his own private advantage (Op. 23a). Judge Hincks recognized, however, that the Court of Appeals might take a different view (Op. 30a); and he carefully qualified his finding as to value by adding in Finding 120 (81a):

> "What value the block would have had if shorn of its appurtenant power to control distribution of the corporate product, the evidence does not show."

Since the burden was on Feldmann, as a commingling fiduciary to show how much of the price he received was for what he had a right to sell and how much for diverting Newport's output of steel, the Court of Appeals (on the undisputed evidence) could properly have entered judgment against him for at least $10 per share (see p. 9 *supra*). Instead the Court remanded the case for further hearing on this question, thus giving Feldmann a further opportunity to demonstrate the fair value of his stock as stock.

CONCLUSION

The decision below was interlocutory. Certiorari "is and generally should be issued only after a final decree"; *Panama R. Co.* v. *Napier Shipping Co.*, 166 U. S. 280, 284 (1897). Review of interlocutory decisions is allowed only where "necessary to prevent extraordinary inconvenience and embarrassment in the conduct of the cause"; *American Construction Co.* v. *Jacksonville T. & K. W. R. Co.*, 148 U. S. 372, 384. No such extraordinary circumstances have been shown. On the contrary, if petitioners, as they now contend, can demonstrate upon the accounting that the price they received was no more than the fair value of their stock, there will be no liability and the legal issues will be academic. The application for certiorari is therefore premature.

Nor does the case involve any of the broad questions which petitioners would seek to present to this Court. The decision below rests, not on the sweeping generalities which petitioners would impute to the Court of Appeals, but on the application of familiar principles of fiduciary law to the particular facts of this case.

It is respectfully submitted that the petition for a writ of certiorari should be denied.

Dated: New York, N. Y., May 22, 1955.

Respectfully submitted,

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